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No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

995 FIFTH AVENUE ASSOCIATES, L.P.,

Petitioner,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether under Section 1146(c) of the Bankruptcy Code the New York State Gains Tax is a "stamp tax or similar tax" from which a Chapter 11 debtor is exempt.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the court below were 995 Fifth Avenue Associates, L.P., a Delaware limited partnership ("Fifth Avenue Associates"); New York State Department of Taxation and Finance, James W. Wetzler, as Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York (collectively, "New York").

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

995 Fifth Avenue Associates, L.P., Debtor, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The amended opinion of the United States Court of Appeals for the Second Circuit (1a)[1] is reported at 963 F.2d 503. The initial opinion of the United States Court of Appeals for the Second Circuit (22a) is unreported. The opinion and order of

1 The pages of the Appendix to this petition are referred to as "____a."

the United States District Court for the Southern District of New York (44a) is reported at 127 Bankr. 533. The opinion of the United States Bankruptcy Court for the Southern District of New York (71a) is reported at 116 Bankr. 384; its judgment and order (68a) is unreported.

JURISDICTION

The court of appeals entered its judgment and filed its opinion on April 13, 1992. On May 8, 1992 the court of appeals filed an amended opinion. The court of appeals denied a petition for rehearing by order dated May 29, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of 11 U.S.C. § 1146(c); Ala. Code § 40-22-1 (Michie Supp. 1991); Del. Code § 5402 (Michie 1985 & Supp. 1990); Ill. Ann. Stat. ch.120, § 1003 (West Supp. 1992); Mass. Gen. Law Ann. ch.64D, § 1 (West Supp. 1992); Minn. Stat. Ann. § 287.21 (West 1989); N.Y. Real Prop. Acts. § 1354 (McKinney 1979 & Supp. 1992); N.Y. Tax Law §§ 1402, 1440, 1441, 1447 (McKinney 1987 & Supp. 1992); N.Y.C. Admin. Code § 11-2102 (Lenz & Riecker 1989); Pa. Stat. Ann. tit. 72, § 8102-C (West 1990); Phil. Code § 19-1403 (Pa. Tax Rep 1989 CCH); Vt. Stat. Ann. tit. 32, § 9602 (Equity 1991); and Wash. Rev. Code §§ 82.45.060, 82.46.010, 82.46.035, 82.46.070 (West Supp. 1992) are set forth in the Appendix.

STATEMENT OF THE CASE

Fifth Avenue Associates was the owner and operator of the Stanhope Hotel (46a). On February 4, 1988 Fifth Avenue Associates filed a petition for relief under Chapter 11 of the Bankruptcy Code (*id.*). By order dated November 29, 1988

the bankruptcy court authorized Fifth Avenue Associates to sell its interest in the Stanhope Hotel as an essential element of its Chapter 11 plan (the "Sale") (*id.*).

A tax of ten percent is imposed by N.Y. Tax Law §§ 1440 *et seq.* (the "Gains Tax") upon what the law describes as "gains derived from the transfer of real property within the state" (114a). The New York State Department of Taxation and Finance (the "Tax Department") imposed a $2,608,603.80 Gains Tax assessment on the Sale (46a). The Tax Department denied a request by Fifth Avenue Associates for an exemption from payment of the tax pursuant to § 1146(c) of the Bankruptcy Code (*id.*). Under New York law a conveyance may not be recorded unless a Gains Tax assessment is paid (*id.*). Consequently, Fifth Avenue Associates paid the Gains Tax under protest to allow the $76 million Sale to close on January 13, 1989 (*id.*).

On March 6, 1989 Fifth Avenue Associates commenced this action in the bankruptcy court seeking, *inter alia*, a judgment that the Sale was exempt from Gains Tax liability pursuant to § 1146(c) of the Bankruptcy Code and an order directing that the Gains Tax payment be refunded (4a). The bankruptcy court subsequently granted a motion for summary judgment by Fifth Avenue Associates. It found that New York had waived its sovereign immunity and eleventh amendment rights by asserting an additional $2,137,496.76 Gains Tax claim against Fifth Avenue Associates, notwithstanding the fact that the proof of claim was filed some months after oral argument (*id.*). The bankruptcy court further found that the Gains Tax was a "stamp tax or similar tax," and thus fell within the § 1146(c) exemption (*id.*). It rejected New York's contention that the Gains Tax was a form of income tax, observing that the Gains Tax was imposed on a transaction by transaction basis without allowing a gain to be offset by losses incurred by other sales during the same time period (77a-80a). The district court affirmed the decision of the bankruptcy court, but was reversed in part by the Second Circuit Court of Appeals (20a-21a). The court of

appeals agreed that New York had waived its claim to sovereign immunity or an eleventh amendment defense by the filing of the proof of claim (11a-12a). However, it rejected the lower court's finding that the Gains Tax was a "stamp tax or similar tax" within the meaning of § 1146(c) (19a-20a).

The district court utilized a three-prong test to define a stamp tax. First, it found that the Gains Tax was imposed only at the time of sale without regard for any other transfers (56a). Second, the district court found that payment of the Gains Tax was a prerequisite for recording a conveyance (*id.*). Third, the district court found that the consideration paid played an essential role in calculating the amount of Gains Tax due, thus satisfying the final element of the three-prong test (*id.*).

The Second Circuit found that the district court ignored three relevant differences between the Gains Tax and a "stamp tax or similar tax" (19a-20a). Most important, the court of appeals observed that the Gains Tax was imposed only when the underlying transaction yielded a gain, while a stamp or similar tax was imposed "irrespective of the existence of gain or profit" (19a). Second, the Second Circuit found that while the amount owed under a stamp tax or similar tax "hinge[d] on the consideration for the transferred item," the consideration was used only as a means for calculating gain in imposing the Gains Tax (20a). Third, the Second Circuit found that the ten percent rate imposed by the Gains Tax was far in excess of the low rates of one percent or less which characterize stamp taxes or documentary transfer taxes (*id.*).

Fifth Avenue Associates, with the support of Sanwa Bank, sought a rehearing from the court of appeals. The Second Circuit filed an amended opinion which recharacterized a one percent tax rate as a guide, rather than a maximum rate which might be imposed by a tax which fell within the § 1146(c) exemption. *Compare* (17a) with (38a) (addition of "typically" and footnote 5 in the amended opinion). The court of appeals

then denied the petition for rehearing without further opinion (98a-99a).

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONFLICTS WITH THE APPROACH ADOPTED BY THIS COURT AND COURTS ACROSS THE NATION TO THE DETRIMENT OF IMPORTANT NATIONAL INTERESTS

This Court has recognized the importance of utilizing Chapter 11 to maximize the value of a debtor's estate. *Toibb v. Radloff*, 111 S.Ct. 2197, 2201 (1991). Chapter 11 has become of unprecedented importance in this period of massive real estate and corporate failures. Section 1146(c) was enacted for the purpose of "facilitat[ing] reorganizations through giving tax relief." *City of New York v. Jacoby-Bender, Inc.* (*In re Jacoby-Bender, Inc.*), 758 F.2d 840, 841 (2d Cir. 1985). The court below has undermined this purpose by unwarrantably reversing the decisions of the lower courts and excluding the Gains Tax from the § 1146(c) exemption.

Courts across the nation have broadly interpreted the Bankruptcy Code's § 1146(c) exemption of the imposition of a "stamp tax or similar tax" upon a transfer made pursuant to a Chapter 11 plan. A broad interpretation of the exemption is consistent with the language of the provision, which under the Bankruptcy Act had been limited only to an exemption from the payment of a stamp tax, *see* 6A *Collier on Bankruptcy* § 15.08 (14th ed.), as compared to the Bankruptcy Code's more expansive "similar tax" exemption. In the decision below, the Second Circuit without explanation reversed the approach it adopted in its earlier decision in *Jacoby-Bender*, 758 F.2d 840, and instead imposed a narrow interpretation on the § 1146(c) exemption. Such a position is in conflict with the approach taken by courts across the nation. *E.g., In re Cantrup*, 53 Bankr. 104 (Bankr. D. Col. 1985); *CCA Partnership v. Direc-*

tor of Revenue (In re CCA Partnership), 70 Bankr. 696 (Bankr. D. Del.), *aff'd*, 72 Bankr. 765 (D. Del.), *aff'd*, 883 F.2d 303 (3d Cir. 1987); *City of New York v. Smoss Enterprises Corp. (In re Smoss Enterprises Corp.)*, 54 Bankr. 950 (E.D.N.Y. 1985); *In re Permar Provisions, Inc.*, 79 Bankr. 530 (Bankr. E.D.N.Y. 1987); *City of New York v. Baldwin League of Independent Schools (In re Baldwin League of Independent Schools)*, 110 Bankr. 125 (S.D.N.Y. 1990). Moreover, in rendering its decision the Second Circuit simply ignored basic rules of statutory construction in interpreting the language of § 1146(c).

In interpreting a statute this Court repeatedly has stated that the starting point should be the language of the statutory provision. *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). Legislative history is only a secondary guide to be utilized when the language in a statute is ambiguous. *Id.*; *Radloff*, 111 S.Ct. at 2200. In the decision below, the Second Circuit turned this basic canon of statutory interpretation on its head. Having found no legislative history which would illuminate the meaning of the text, the court of appeals simply terminated its consideration of the meaning of the term "similar tax."

When asked to interpret a Bankruptcy Code exemption this Court will give a "natural reading" to the "plain language" of the provision. *Patterson v. Shumate*, 112 S.Ct. 2242, 2246 (1992). When everyday English is used, this Court will assume Congress intended to give a word its "ordinary meaning," the meaning ascribed to it in "ordinary parlance" and in "dictionary definitions." *United Air Lines, Inc. v. McMann*, 434 U.S. 192, 203 (1977). In everyday English "similar" is understood to mean "having a likeness or resemblance, esp. in a general way. . . ." *The Random House Dictionary of the English Language* 1782 (2d ed. unabrgd 1987). Had the Second Circuit attempted to apply such a definition in its analysis of § 1146(c), the Gains Tax would have been found to fall within the exemption's purview.

The meaning of the term similar frequently has arisen in interpreting the United States tariff laws. In *Greenleaf v. Goodrich*, 101 U.S. 278 (1879) this Court was asked to determine the meaning of the term "goods of similar description." It recognized that differences existed between the goods being subjected to scrutiny and the type of goods specifically cited in the tariff law in question. *Id.* at 281. However, this Court did not find that the existence of some differences, by themselves, was sufficient. It wrote:

> The words "of similar description" in the delaine clause of the act of 1862 cannot be affirmed to have referred only to such goods as have the greater number of characteristics in common with delaines. Some common characteristics are of much more importance than others in determining resemblances.

Id. at 282. This need to evaluate the differences in goods to determine whether they are of a similar nature has continued to be a basic element in interpreting the tariff laws. *See, e.g., E. Dillingham, Inc. v. United States*, 328 F.Supp. 1392, 1400-02 (Cust. Ct. 1971). The need to weigh differences has also been found to be necessary in determining whether goods are similar in connection with tax exemptions. *See City of Phoenix v. Marathon Steel Co.*, 722 P.2d 341, 344-45 (Ariz. App. 1985) (differences outweigh similar features, causing steel company to be exempt from local license fee).

In considering the applicability of a tax exemption this Court will not treat two taxes differently, unless they differ in a "significant way." *United States v. New Mexico*, 455 U.S. 720, 738 (1982). Where the application of a tax exemption is contingent upon whether a tax is similar in nature to another tax, the tax under scrutiny must be "systematically analyzed" and its operation assessed by some "cogent theory of what makes a tax 'similar'. . . ." *Colorado Interstate Gas Co. v. Federal Energy Regulatory Comm'n*, 850 F.2d 769, 773 (D.C. Cir. 1988). Without such a systematic evaluation there would be an elevation of

form over substance. *See Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 444 (1827) (license fee imposed upon sellers of imported goods cannot escape constitutional prohibition against imposition of duties on imports by individual states based upon claim that tax is upon seller's occupation rather than upon imported goods).

If the court below had undertaken a systematic analysis of the meaning of the term "similar tax" rather than relying upon a faulty, incomplete survey, it would have found that the district court was correct in defining the Gains Tax as a "stamp tax or similar tax." The distinguishing characteristics which the Second Circuit identified as taking the Gains Tax outside of the § 1146(c) exemption either do not exist or are of too minor importance to cause the Gains Tax to be dissimilar to a stamp tax.

In its amended opinion the court below found that the Gains Tax was not similar to a stamp tax because of the ten percent rate at which the Gains Tax is imposed as compared to the usual one percent or less rate imposed by taxes within the § 1146(c) exemption (20a). The Second Circuit ignored the existence of stamp taxes with a rate in excess of one percent throughout the country. Contrary to statements made in the opinion, the Vermont property transfer tax is imposed at a rate of 1.25%. (*See* 16a, 123a).[2] The realty transfer tax in Delaware is imposed at a rate of 2% of the value of the property (102a). Philadelphia imposes a real property transfer tax of 3.46% (121a-22a). The state of Pennsylvania imposes an additional tax of 1% (120a), which increases the total tax burden on real estate transfers to 4.46%. In the state of Washington, the combined local and state real property transfer tax rate may be as high as 3.28% (124a-27a). Numerous real property transfer and

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2 The ½% rate cited in the decision below is applied only to the first $100,000.00 in value of sales of principal residences and other limited exceptions to the 1.25% rate. (*id.*) This mischaracterization of the Vermont tax rate in the opinion below is reflective of the faulty analysis upon which the Second Circuit's decision is based.

recording taxes in the New York metropolitan area have a rate in excess of one percent, including the New York City Real Property Transfer Tax (the "RPT"), which is imposed at a rate of 2.625% when gross consideration exceeds $500,000.00 (118a-19a).

In its amended opinion the Second Circuit attempted to minimize the extent of its faulty analysis by recharacterizing a rate of one percent or less as typical, rather than as an absolute maximum for a tax which fell within the § 1146(c) exemption. However, the more basic failure in the Second Circuit's analysis remained unaddressed. A high tax rate is significant because of the greater burden a high rate imposes. Because the Gains Tax is imposed upon only a portion of the consideration, it is misleading to focus only upon the difference in the rates between the Gains Tax and other taxes which are recognized as falling within the § 1146(c) exemption. For example, rather than there being a great disparity between the Gains Tax and the RPT, an examination of how these taxes operate reveals that they are taxes of comparable magnitude.

Using a $76,000,000.00 sale price, the price paid for the Stanhope Hotel, a tax of $1,995,000.00 would be imposed by the RPT. When combined with an additional $304,000.00 which would be exacted by the New York State Real Estate Transfer Tax (the "RETT") (*see* 109a), a total of $2,299,000.00 in these taxes would be imposed on a $76,000,000.00 sale, only twelve percent less than the $2,608,603.80 Gains Tax recovery being sought by Fifth Avenue Associates. Moreover, if the sale price in the above example is reduced to a hypothetical, but still very respectable $60,000,000.00, the Gains Tax would be approximately $1,000,000.00, less than two-thirds the amount of the $1,575,000.00 which would be exacted by the RPT alone. Thus, the difference in tax rates cited by the Second Circuit is not the kind of difference which would cause the Gains Tax to be dissimilar to a stamp tax, because the difference in rates does not result in a corresponding difference in magnitude.

The decision below also rests on the premise that a "stamp tax or similar tax" is determined solely by using "either the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction" (17a). The decision contrasts such a measure of taxation with the Gains Tax calculation in which the court below stated that "the consideration is used only as a means to measure the gain accruing to the transferor as a result of the transfer" (20a). Again, the Second Circuit has overlooked examples of stamp or similar taxes which are not calculated by using par value and which only utilize a portion of the consideration or the value of the transferred item in deriving the amount of the tax.

For example, the decision below cites the New York State RETT as a tax which falls within the § 1146(c) exemption (16a). However, when the RETT is applied to the transfer of a single family home, or when the consideration is less than $500,000.00, the value of any continuing lien will be excluded (109a). Thus, if an individual purchases a house for $600,000.00, pays $200,000.00 in cash and the remainder by assuming an outstanding mortgage of $400,000.00, the RETT will be calculated by using only $200,000.00 as the base. This amount is neither the consideration, the value of the property being transferred, nor par value, the alternative values upon which the court below stated a tax must be imposed in order to fall within the § 1146(c) exemption.

The practice of deducting the amount of outstanding mortgages is not limited to New York. In Alabama, Illinois, Massachusetts and Minnesota the amount of an assumed mortgage is also deducted in calculating those states' real property transfer taxes, in both residential and commercial transactions.[3]

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3 The decision as to whether to allow the value of outstanding mortgages to be deducted from the taxable base can have a major impact on the magnitude of a tax. For example, in a commercial transaction where a purchaser was seeking a 10% return on an investment, he would be willing to pay $11,700,000.00 ($7,000,000.00 in cash and $4,700,000.00 by assuming an existing mortgage) for a building which produced

See 101a, 104a-106a. Thus, the decision below again distinguishes the Gains Tax from a stamp tax by isolating a difference which would confuse the application of the § 1146(c) exemption in other parts of the country. If these other taxes fall within the § 1146(c) exemption, why should the Gains Tax be excluded?

Ultimately, the only alleged difference identified by the Second Circuit which has any real significance is the claim that liability for the Gains Tax is "always contingent on the profitability of the underlying transaction" (19a). As measuring profit under the Gains Tax formula does not allow for an offsetting of losses from other transactions during the same tax period (77a), this difference alone should not be sufficient to place the Gains Tax outside of the § 1146(c) exemption. However, consideration of this question is unnecessary, as the Gains Tax, contrary to the unsubstantiated position taken by the Second Circuit, is imposed even when a seller suffers a loss.

Last year the manner in which profits are calculated under the Gains Tax law received detailed scrutiny in the joint report of the New York State Bar Association Tax Section and The Association of the Bar of the City of New York Committee on State and Local Taxation, *Application of the New York State 10% Tax on Gains Derived from Certain Real Property Transfers to Transfers Involving Interests in Troubled Real Estate* (1991) (hereinafter described as *Bar Assoc. Rep.*). This report identified major costs which are disallowed in calculating gain including interest on land acquisition loans during construction, pre-construction zoning approval costs and the post-construction costs of carrying unsold and unleased space. *Id.* at

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$700,000.00 per year in net income after taxes and debt service. If the transaction occurred in a state with a one percent tax rate which allowed the amount of an existing mortgage to be deducted, the tax would be $70,000.00 based upon a $7,000,000.00 cash base. If a state required the amount of an outstanding mortgage to be included in the stamp tax calculation, the tax would be $117,000.00, a 67% greater amount, as the one percent rate would be applied to the full $11,700,000.00 of consideration.

14-26. The bar association committees concluded that the Gains Tax "is imposed on phantom gains, and sometimes is imposed even where there is an economic loss on the project." *Id.* at 4. If the Gains Tax is imposed on transactions in which losses are incurred, the Second Circuit's reliance upon a belief that the Gains Tax is imposed only on profitable transactions is clearly without merit.

The facts in this case reflect the extent to which the Gains Tax is imposed on transfers in which there is an economic loss incurred. Creditor claims are at least $14,000,000.00 greater than the assets of Fifth Avenue Associates. If the exemption of the Gains Tax under § 1146(c) is reinstated, the likely primary beneficiary in this case will be the Resolution Trust Corporation, which holds a non-administrative expense claim of approximately $10,000,000.00. The Federal Deposit Insurance Corporation also has interest in the outcome of this appeal, given its large holdings of troubled mortgages on New York properties.

If the Second Circuit's analysis of the Gains Tax is allowed to stand, it will serve as an invitation for state and local governments to bring unwarranted challenges to a Chapter 11 debtor's rightful use of the § 1146(c) exemption. Earlier cases involving § 1146(c) reflect the unsubstantial distinctions which are likely to be asserted. For example, in *Cantrup*, the City of Aspen argued that its real estate transfer tax was not exempt under § 1146(c) because it was the purchaser, not the Chapter 11 debtor, "who accepted the deed and present[ed] it for recording." 53 Bankr. at 105. The *Cantrup* Court rejected this argument by noting that, "while the City's argument has initially a certain ingenius [sic], abstruse and abstract intellectual appeal, it fails to make a practical distinction." *Id.* at 106. Obviously, there is no meaningful difference between the delivery and recording of a deed in this context. Once a state establishes a system for recording conveyances, a purchaser of real property must record a transfer to protect its rights of ownership. *Baldwin League of Independent Schools*, 110 Bankr. at

127. By failing to evaluate the significance of the tax characteristics upon which its opinion relies, the Second Circuit has created precedent for comparable specious future challenges to the application of the § 1146(c) exemption. As described earlier, numerous real estate transfer taxes fail to conform to the narrow criteria for a "stamp tax or similar tax" established by the Second Circuit. Unwarranted challenges which will delay reorganizations and deplete the limited resources of Chapter 11 debtors will be encouraged, unless this Court establishes an appropriate guide for applying the § 1146(c) exemption.

New York City has the greatest concentration of office buildings in this country. More than thirty percent of this nation's downtown commercial office space is located in the New York City metropolitan area. U.S. Dept of Commerce, *Statistical Abstract of the United States 1991* at 733. Thus, many individuals and institutions throughout this country who have made loans or invested in New York real estate will be affected by the outcome of this case. In this period of mounting real estate failures the § 1146(c) exemption is of growing importance. The differences in tax characteristics relied upon by the Second Circuit cannot withstand scrutiny. Given the significance of the § 1146(c) exemption to local and national interests, and even international lenders (see section II, *infra*), this Court should not allow the mistaken analysis of the Second Circuit Court of Appeals to go unreviewed. Its decision should not be allowed to frustrate Congress's intention to facilitate Chapter 11 reorganizations by providing tax relief.

II. THE DECISION BELOW ALLOWS FOR THE CONTINUED DISCRIMINATORY IMPOSITION OF THE GAINS TAX IN VIOLATION OF THE DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY

The imposition of the Gains Tax on transfers which produce no gain resulted in a 1984 revision of the New York foreclosure law which subordinated the payment of the Gains Tax to the satisfaction of existing mortgages when a property is trans-

ferred in a foreclosure sale. Bar Assoc. Rep. at 1-2, 31-32. Now, before the Gains Tax is paid, the proceeds of a sale are used to satisfy existing mortgages on the property. Only if excess monies remain are sale proceeds used to satisfy the Gains Tax (107a-108a). In addition, the Gains Tax law was amended by the addition of § 1447.3(b) to eliminate the secondary liability of a transferee to pay the Gains Tax, if the property is transferred in an action to foreclose a mortgage (116a).

No such adjustments are made if a property is sold in bankruptcy. In bankruptcy even when the sale proceeds are insufficient to satisfy existing mortgages, the deed will not be recorded unless the Gains Tax is paid. Moreover, transferee liability continues. This less favorable tax treatment of troubled properties in bankruptcy represents a disparate imposition of the Gains Tax which violates the constitutional protections afforded by the doctrine of intergovernmental tax immunity.

The doctrine of intergovernmental tax immunity was first established in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). The doctrine is directed at preventing state and local tax authorities from imposing burdens which interfere with the activities of the federal government and the exercise of congressional power. *Davis v. Michigan Dept of Treasury*, 489 U.S. 803, 810 (1989); *City of Detroit v. Murray Corp. of America*, 355 U.S. 489, 496-97 (1958).

Over the last fifty years the scope of the intergovernmental tax immunity doctrine has been reduced. *Davis*, 489 U.S. at 811. The imposition of a non-discriminatory economic burden upon a federally sponsored activity is no longer barred. *United States v. County of Fresno*, 429 U.S. 452, 462 (1977). However, taxes remain constitutionally invalid if they are discriminatory in nature. *E.g.*, *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376 (1960); *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961). Even significant differences between the entities being taxed will not justify disparate tax treatment unless the differences can be shown to

be directly related to the inconsistent tax treatment. *Davis*, 489 U.S. at 816; *Barker v. Kansas*, 112 S.Ct. 1619, 1623 (1992). Included within this constitutional prohibition against disparate tax treatment are discriminatory state taxes which place additional burdens upon the sale of property in bankruptcy. *California State Board of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 850 n.6. (1989).

The inequitable and discriminatory effect of the disparate imposition of the Gains Tax in state foreclosure and bankruptcy sales was described in Sanwa Bank's *amicus curiae* brief in support of Fifth Avenue Associates' petition for a rehearing to the Second Circuit:

> In the current environment, if this Court's [Second Circuit's] decision is given effect, it will be the mortgage lender, not the borrower, that will pay the New York Transfer Gains Tax in Chapter 11 restructurings. . . . The following example will illustrate a typical scenario faced by commercial real estate lenders in New York.
>
> A developer has borrowed $200 million from a bank pursuant to a nonrecourse mortgage loan to fund the construction of a building. After completing construction of the building, the developer's "original purchase price" for New York Transfer Gains Tax purposes is only $150 million because, in part, the New York Transfer Gains Tax rules arbitrarily exclude certain capital expenditures from the calculation of original purchase price. Due to current conditions in the New York real estate market, the building has a current fair market value of $100 million. The developer is in default on his mortgage, the lender commences a foreclosure action and the developer responds by filing for protection under Chapter 11 of the Bankruptcy Code.
>
> Assuming under either the foreclosure or Chapter 11 scenario the building will be transferred to the bank in satisfaction of its claim, the face amount of the mortgage

> ($200 million) will be treated as the consideration for purposes of computing the New York Transfer Gains Tax. The developer will be treated as having a $50 million taxable gain, and the New York Transfer Gains Tax will be $5 million. If the developer has insufficient cash to pay the tax, which is likely to be the case, the bank in the Chapter 11 case, but not the foreclosure scenario, will be required to pay the tax before it can record its deed. Thus, the bank, which already has suffered substantial economic loss, will be out-of-pocket the additional amount of the New York Transfer Gains Tax.
>
> * * *
>
> The Court's decision may well lead lenders to pursue contested foreclosures rather than to participate in consensual Chapter 11 proceedings . . . resulting in a series of contested motions to the detriment of the reorganization process and at great expense to the estate. . . . A further effect of pursuing foreclosure rather than Chapter 11 will be that mechanics' lienors and unsecured creditors will receive nothing in satisfaction of their claims. In contrast, those creditors frequently receive some distributions from estates in Chapter 11.

Brief of the Sanwa Bank Limited, New York Branch, As *Amicus Curiae*, In Support of Petition for Reargument and Suggestion for Rehearing In Banc at 5-8 (2d Cir. 1992) (No. 91-5038) (citations omitted).

The Second Circuit refused to consider the disparate burden created by the Gains Tax if the problems of troubled properties are addressed in bankruptcy rather than through foreclosure. This disparate treatment unfairly penalizes property owners and creditors who want to avail themselves of the bankruptcy process rather than utilizing state foreclosure remedies. The imposition of additional losses on financially weakened lenders has the further effect of reducing the availability of new loans in an

environment already suffering from a shortage of capital.[4] Such inequitable and discriminatory burdens are barred by the doctrine of intergovernmental tax immunity.

If the decision below is allowed to stand the constitutionality of the Gains Tax will be placed in jeopardy. This Court repeatedly has stated that, where possible, a statute should be interpreted so as to avoid a constitutional infirmity. For example, in *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg & Constr. Trades Council*, 485 U.S. 568 (1988), this Court stated:

> [W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.

Id. at 575. This same rule is applicable where constitutional problems arise in interpreting state statutes. *See, e.g., Hooper v. California*, 155 U.S. 648, 657 (1895). By addressing the faulty construction of the § 1146(c) exemption by the Second Circuit Court of Appeals, this Court may avoid problems "of the greatest difficulty and delicacy," which arise in the interpretation of intergovernmental tax immunity questions. *United States v. City of Detroit*, 355 U.S. 466, 474 (1958). Given the economic importance and legal significance of the question presented, this Court's direction is needed in settling this controversy.

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4 James W. Wetzler, one of the respondents in this case, has stated: " 'Long after the recession is over, the way this tax [Gains Tax] has worked in workout situations may make banks less willing to lend on New York real estate.' " *Crain's New York Business*, July 8, 1991 at 3.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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August 27, 1992

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 416—August Term, 1991

(Argued October 28, 1991 Decided April 13, 1992)
(Amended Opinion Filed May 8, 1992)

Docket No. 91-5038

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,
Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.,
Plaintiff-Appellee,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, as Commissioner of Taxation and Finance; EDWARD V. REGAN, as Comptroller of the State of New York,
Defendants-Appellants.

Before:

OAKES, *Chief Judge,*
FEINBERG and ALTIMARI, *Circuit Judges.*

The New York State Department of Taxation and Finance, James W. Wetzler, as New York Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York, appeal from an order of the United States District Court for the Southern District of New York (Leonard B. Sand, *Judge*) affirming the opinion and order of the Bankruptcy Court (Tina L. Brozman, *Bankruptcy Court Judge*). The Bankruptcy Court granted 995 Fifth Avenue Associates, L.P.'s motion for summary judgment and ordered the New York State Department of Taxation and Finance to refund New York Gains Tax, N.Y. Tax Law § 1441 (McKinney 1987) paid by 995 Fifth Avenue Associates, L.P.

Affirmed in part and reversed in part.

DAVID S. COOK, Senior Attorney, Attorney General's Office, State of New York, New York, NY (Robert Abrams, Attorney General, Frederic L. Lieberman, Marcie S. Mintz, Assistant Attorneys General, of counsel), *for Defendants-Appellants*.

JOSHUA J. ANGEL, New York, NY (Leonard H. Gerson, Ira R. Abel, Angel & Frankel, P.C., of counsel), *for Plaintiff-Appellee*.

OAKES, *Chief Judge*:

This appeal requires us to decide whether the Eleventh Amendment bars a debtor's suit to recover taxes paid to the State of New York, and whether 11 U.S.C. § 1146(c)

(1988) exempts the debtor from payment of the New York gains tax on the transfer of property, N.Y. Tax Law § 1441 (McKinney 1987). The United States Bankruptcy Court for the Southern District of New York, Tina L. Brozman, *Bankruptcy Court Judge*, found that the New York State Department of Taxation and Finance, James W. Wetzler, as New York Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York (collectively "State of New York," "New York," or "appellant") waived the State of New York's immunity from suit by filing a proof of claim in the bankruptcy proceeding, found that the debtor was exempt from the gains tax, and accordingly ordered New York to refund the gains tax paid by the debtor, 995 Fifth Avenue Associates, L.P. ("Fifth Avenue"). New York appealed to the United States District Court for the Southern District of New York. Leonard B. Sand, *District Judge*, affirmed the opinion and order of the bankruptcy court and the State of New York now appeals.

For the reasons set forth below, we affirm in part and reverse in part.

BACKGROUND

The relevant facts are not in dispute. The debtor, Fifth Avenue, operated the Stanhope Hotel. It filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code in February of 1988 and thereafter continued to operate the hotel as debtor in possession. Pursuant to a plan of reorganization, the bankruptcy court authorized the sale of Fifth Avenue's interest in the hotel at a price of $76 million. The court's order specifically declared that, because the sale was part of a plan of reorganization, § 1146(c) rendered the sale exempt from all transfer taxes.

On January 12, 1989, the day before the scheduled closing, in accordance with N. Y. Tax Law § 1447 (McKinney 1987), New York issued a Tentative Assessment and Return imposing a gains tax of $2,608,603.80 on the sale of the property. New York subsequently denied the debtor's request for an exemption from the tax under 11 U.S.C. § 1146(c). Because New York law prohibits recordation of the deed without payment of tax due under a Tentative Assessment and Return, Fifth Avenue could not close the sale as scheduled without paying the gains tax. Faced with this dilemma, the debtor paid the tax under protest, enabling it to record the deed and close the sale.

In March 1989, the debtor brought an adversary proceeding in bankruptcy court against the State of New York, seeking, *inter alia*, a declaration that § 1146(c) exempted the debtor from the gains tax, and an order directing that the payment made to New York be refunded. Some months later, after the bankruptcy court heard oral argument in the proceeding, the State of New York filed an administrative expense claim for gains tax liability of $2,137,496.76, an amount in addition to the approximately $2.6 million already imposed by the state and paid by the debtor.

The bankruptcy court found that the debtor's sale was exempt from the gains tax under § 1146(c). In response to the State of New York's Eleventh Amendment immunity argument, the bankruptcy court held that pursuant to 11 U.S.C. § 106(a) (1988), New York had waived its Eleventh Amendment immunity by filing the administrative expense claim for additional gains tax. The district court affirmed the decision and order of the bankruptcy court.

DISCUSSION

I. Eleventh Amendment Immunity

Appellant argues that the Eleventh Amendment barred both the bankruptcy court and the district court from considering whether the debtor was exempt from payment of the New York gains tax. The Eleventh Amendment, where applicable, deprives a federal court of jurisdiction. *See Edelman v. Jordan*, 415 U.S. 651, 678 (1974). Thus, prior to addressing the merits of this case we must first determine whether Eleventh Amendment immunity bars our jurisdiction. We hold that it does not.

The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

The reach of the amendment was judicially expanded beyond its text in *Hans v. Louisiana*, 134 U.S. 1 (1890), to bar citizens from suing their own states in federal court. The Supreme Court has also consistently held that federal suits by private citizens that seek damages to be paid out of the state treasury are barred by the Eleventh Amendment. *See, e.g., Quern v. Jordan*, 440 U.S. 332, 337 (1979).

Despite this general bar to suits against states created by the Eleventh Amendment, there are two well-established ways to provide judicial power over such cases: abrogation of immunity by Congress and waiver of immunity by a state. *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 99 (1984). A purported Con-

gressional abrogation of Eleventh Amendment immunity is not effective, however, unless it meets a two-part test set forth by the Court. First, Congress must make its intent to abrogate Eleventh Amendment immunity "unmistakably clear." *Pennsylvania v. Union Gas Co.*, 491 U.S. 1, 7 (1989) (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985)). Second, the constitutional provision under which Congress legislates its purported abrogation must grant Congress the power to override the Eleventh Amendment. *Union Gas*, 491 U.S. at 13-23. Abrogation of Eleventh Amendment immunity typically occurs when Congress enacts a new federal statutory cause of action. *See, e.g. Fitzpatrick v. Bitzer*, 427 U.S. 445, 456 (1976) (Eleventh Amendment immunity abrogated for suit to recover damages from the State for gender-based employment discrimination under Title VII); *Union Gas Co.*, 491 U.S. at 23 (Eleventh Amendment immunity abrogated for suit to recover costs from the State for environmental clean-up under CERCLA).

Waiver of Eleventh Amendment immunity, in contrast to abrogation, is not hinged to a specific federal statutory cause of action. Instead, it is triggered by some affirmative activity of a state, such as a state's enactment of legislation by which it consents to be sued in federal court, *see, e.g., Port Auth. Trans-Hudson Corp. v. Feeney*, 495 U.S. 299, 307-09 (1990), and, as here, a state's participation in litigation in federal court. In *Clark v. Barnard*, 108 U.S. 436, 447-48 (1883), for example, the State of Rhode Island was deemed to have waived its Eleventh Amendment immunity by intervening in a case as a claimant of a fund. And the Court in *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947), held that where the State of New Jersey filed a claim against a fund in bankruptcy court, in a case where no judgment was sought against the

State, the State waived its immunity. Thus, as the district court noted, it is long-established that a state's participation in a bankruptcy proceeding can trigger a waiver of immunity.

The State of New York does not take issue with this general principle. Rather, it argues that the provision of the Bankruptcy Code under which the bankruptcy court deemed the State to have waived its Eleventh Amendment immunity—11 U.S.C. § 106(a)—represents an abrogation provision, not a waiver scheme. As an abrogation provision, New York contends, § 106(a) is unconstitutional because Congress lacks the authority to abrogate sovereign immunity when enacting legislation under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4. We disagree with New York's characterization of § 106(a).

Section 106(a) provides:

> A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

The plain meaning of these words obviously reflects Congress's intent to provide a *waiver* of immunity where "a governmental unit" files a claim in the bankruptcy court. The scope of the waiver, of course, remains limited; upon filing a claim the governmental unit subjects itself only to claims that arose from the same transaction or occurrence that formed the basis of the governmental unit's claim. Our conclusion derives further support from two recent cases where the Supreme Court, albeit in dicta, stated that § 106(a) provides for a limited waiver of immunity. *See Hoffman v. Connecticut Income Maint.*

Dept., 492 U.S. 96, 101-02 (1989); *U.S. v. Nordic Village, Inc.*, No. 90-1629, slip op. at 4-6 (U.S. Feb. 25, 1992).

In addition, Congress did not use the language of abrogation in §106(a). Compare, for example, the language used by Congress in *Union Gas*, where the Court held that Congress abrogated Eleventh Amendment immunity in making states liable for cleanup costs under CERCLA. *Union Gas*, 491 U.S. at 13. In the provisions there at issue, Congress stated that any "person," "owner[,] and operator" shall be liable. 42 U.S.C. § 9607(a) (1988). Congress went on to include states in the definition of a "person," 42 U.S.C. § 9601(21), and except in very limited situations Congress provided that states fall within the meaning of the term "owner or operator." *See* 42 U.S.C. § 9601(20)(D). Thus, CERCLA contains the language of abrogation by clearly stating that states can be liable for cleanup costs. Section 106(a) contains no similar statement regarding the liability of states for a specific class of damages.

Not only is the wording of § 106(a) different from language aimed at a general override of immunity, but this provision provides for suits against states by a route that differs markedly from the typical abrogation context. Typically, abrogation occurs when Congress has enacted a cause of action generally and seeks to render states, in particular, liable for damages "along with everyone else." *Union Gas*, 491 U.S. at 8. Section 106(a), however, renders a state liable to suit only when the state participates in a bankruptcy proceeding by filing a claim.

Thus, § 106(a) creates a waiver scheme; it is not an abrogation provision. Indeed, the section largely partakes of the waiver by participation doctrine that received the Supreme Court's imprimatur in *Gardner*, 329 U.S. at 574.

Because we find that § 106(a) specifies when a state has waived its Eleventh Amendment immunity, we need not address appellant's contention that Congress lacks the authority to abrogate sovereign immunity when enacting legislation under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4.

Next, we consider the validity of the purported waiver of Eleventh Amendment immunity under § 106(a). We note at the outset that, like the First Circuit, we see no constitutional barrier to a waiver of Eleventh Amendment immunity as provided in § 106(a). In *WJM, Inc. v. Massachusetts Dept. of Public Welfare*, 840 F.2d 996, 1002-005 (1st Cir. 1988), the court held that Congress possesses the authority to condition a state's participation in a bankruptcy proceeding on its waiver of Eleventh Amendment immunity. The court in *WJM* relied in part on *Atascadero*, where the Court considered whether states can be sued for damages under a Congressionally-created cause of action. In *Atascadero*, the Court determined that the Congressional legislation in question fell "far short of manifesting a clear intent to condition participation in the programs funded under the Act on a State's consent to waive its constitutional immunity." *Atascadero*, 473 U.S. at 247. After citing this language, the *WJM* court reasoned:

> The logical inference from this and other language in *Atascadero*, however, is that Congress *may* effectively condition a state's participation in a federal program on a state's consent to federal jurisdiction, so long as Congress manifests a clear intent to this effect.

WJM, 840 F.2d at 1003. We agree with the First Circuit's analysis.

Our conclusion regarding Congressional authority, however, does not end the inquiry, because we will only give effect to Congressional legislation that purports to condition state participation in litigation on a state's waiver of Eleventh Amendment immunity when Congress "manifest[s] a clear intent" to do so. *Atascadero*, 473 U.S. at 247. This requirement is analogous to the test the Court applies to determine the validity of a state's waiver of Eleventh Amendment immunity by state legislation. In that context, "[t]he Court will give effect to a State's waiver of Eleventh Amendment immunity 'only where stated by the most express language or by such overwhelming implication from the text as [will] leave no room for any other reasonable construction.' " *Feeney*, 495 U.S. at 299 (quoting *Atascadero*, 473 U.S. at 239-40 and *Edelman*, 415 U.S. at 673). We discern no substantive difference between the test for a Congressional waiver scheme, as set forth in *Atascadero*, and the test for a waiver by state legislation, as applied in *Feeney*. Thus, we must again turn to the language of § 106(a) to determine whether it plainly requires a waiver of Eleventh Amendment immunity and "leave[s] no room for any other reasonable construction." *Atascadero*, 473 U.S. at 240.

Appellant argues that no such waiver of Eleventh Amendment immunity is implicated by § 106(a) because, by its terms, it fails to mention the Eleventh Amendment. Explicit mention of the Eleventh Amendment, however, has never been a requirement for waiver of immunity. For example, in *Feeney*, the Court found that by statute the states of New York and New Jersey had waived their Eleventh Amendment immunity, but nowhere did the statutory provisions mention the Eleventh Amendment. *Feeney*, 495 U.S. at 303, 306-09. *See also Dellmuth v. Muth*, 491 U.S. 223, 233 (1989) (Scalia, *J.*, concurring)

(statutory text may override Eleventh Amendment immunity without explicit reference to either state sovereign immunity or the Eleventh Amendment). Similarly, the text's failure specifically to mention states is irrelevant: § 106(a) uses the term "governmental unit," which the Bankruptcy Code defines in 11 U.S.C. § 101(26) (1988) as including a "State." To hold otherwise would ignore the fact that Congress routinely expresses its intent with statutes drafted with definitional cross-references.[1] Accordingly, we find that § 106(a) plainly expresses Congress's intent to provide for a limited waiver of Eleventh Amendment immunity and "leave[s] no room for any other reasonable construction." *Atascadero*, 473 U.S. at 240.

Applying § 106(a) to the facts of this case, we find that the State of New York, by filing an administrative expense claim for $2,137,496.76, waived its Eleventh Amendment immunity with respect to the $2,608,603.80 million in gains tax paid by the debtor. As we have stated, § 106(a) provides for waiver of Eleventh Amendment immunity from any claim against the state "that arose out of the same transaction or occurrence out of which such governmental unit's claim arose." Here, the State's administrative expense claim arose from additional gains tax levied on the sale of the Stanhope Hotel. Fifth Avenue's claim against the State for a refund also arose from gains tax imposed on the sale of the Stanhope Hotel. Thus, appellee's claim for a tax refund arose from the same transaction or occurrence—the sale of the Stanhope Hotel—as the State's claim for additional taxes. Accord-

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1 The State of New York also argues that § 106(a) is insufficiently clear because it does not mention the filing of a proof of claim. We do not believe this fact renders Congress's intent unclear, because the only reasonable construction of § 106(a) is that waiver will arise only if a claim is actually filed.

ingly, the Eleventh Amendment does not bar us from reaching the merits of this case.

II. Whether the Gains Tax is a "Stamp Tax or Similar Tax"

We now consider whether the New York gains tax, N.Y. Tax Law § 1441 (McKinney 1987), is a "stamp tax or similar tax" within the meaning of 11 U.S.C. § 1146(c). Because the New York gains tax is not a "stamp tax or similar tax," we hold that 995 Fifth Avenue is not entitled to an exemption from the gains tax.

A.

We begin our discussion with an analysis of the type of taxes from which Congress intended to exempt qualifying debtors when it enacted 11 U.S.C. § 1146(c). Starting with the text, section 1146(c) provides:

> The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

The Bankruptcy Code supplies no definitions for the terms "stamp tax" or "similar tax." Thus, we must look to the legislative history for assistance in determining what Congress meant by the phrase "stamp tax or similar tax." This history, however, provides limited guidance.

Section 1146(c), enacted as part of Title 11 and the general revision of the federal bankruptcy laws in 1978, was derived from § 267 of the Bankruptcy Act of 1898, as amended by the Chandler Act of 1938, ch. 575, § 267, 52 Stat. 840, 902-03 (1938) (repealed in 1979). In essence,

the new provision broadened the scope of the exemption to include taxes "similar" to stamp taxes: whereas § 267 exempted the debtor from "any stamp taxes now or hereafter imposed," § 1146(c) provides exemption from "any law imposing a stamp tax *or similar tax*" (emphasis added).[2] The legislative history surrounding the enactment of § 1146(c) does not illuminate what Congress meant when it added the words "or similar tax."

Similarly, there is no relevant legislative history to shed light on Congressional intent behind the enactment of the earlier exemption provision, § 267, which was part of the Chandler Act of 1938. Section 267 greatly changed the wording of its precursor provision, § 77B(f) of the Bankruptcy Act, as amended by the Act of June 7, 1934, ch. 424, § 77B(f), 48 Stat. 911, 919 (1934) (amended in 1938). Section 267 used general language to expand an exemption that had shielded qualified debtors from federal stamp taxes only into one that shielded such debtors from state stamp taxes as well. *See* 11 Harold Remington, A Treatise on the Bankruptcy Law of the United States § 4654 (Kenneth A. Hayes, ed., rev. 1961).

Section 77B(f), the original source of the stamp tax exemption, was added to the Bankruptcy Act by the Act of June 7, 1934, and represented Congress's first effort to provide for the reorganization of corporations in bankruptcy. 1 Harold Remington & James A. Henderson,

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2 The report of the House Judiciary Committee stated that "[s]ection 1146(c) of title 11 broadens the exemption to any stamp or similar tax." H.R. Rep. No. 595, 95th Cong., 1st Sess. 281 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6238. We disagree with the district court to the extent it concluded that this statement reflects Congress's intent that the words "stamp or similar tax" be read broadly to accord greater tax relief for debtors. Instead, we regard this statement as a simple declaration that the new provision, § 1146(c), enlarges the former exemption under § 267 to include taxes similar to stamp taxes.

A Treatise on the Bankruptcy Law of the United States § 10 (5th ed. 1950). By its terms, § 77B(f) provided debtors with exemptions from only specific federal stamp taxes on the issuance and transfer of stock and bonds and on conveyances of realty. One of the purposes of § 77B(f) was to exempt the debtor from the payment of federal stamp tax on new securities issued pursuant to a plan of reorganization that required the debtor to modify the terms of outstanding securities for which stamp tax had already been paid.[3] *See* S. Rep. No. 482, 73rd Cong., 2d Sess. 4 (1934). In sum, although the legislative history shows that the scope of the § 1146(c) tax exemption has expanded since its original enactment in 1934, it fails to indicate whether the New York gains tax qualifies as a "stamp tax or similar tax."

Absent more explicit guidance from either the text or the legislative history, we must interpret the words used by Congress in accordance with "their ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). Dictionaries represent one source of such common meaning. *See, e.g., United States v. Adames*, 901 F.2d 11, 12 (2d Cir. 1990). Black's Law Dictionary 1259 (5th ed. 1979) defines "stamp tax" as the "cost of stamps which are required to be affixed to legal documents such as deeds, certificates, and the like." The definition also contains a cross-reference to "[d]ocumentary stamp," which Black's defines as "[s]tamp required by federal (prior to 1968) and state law to be affixed to deeds and other documents of transfer before they may be recorded, the cost of which is generally governed by the consideration recited in the document." This

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3 These stamp taxes were repealed by the Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, § 401(b), 79 Stat. 148 (1965), effective January 1, 1968.

definition indicates that there are at least two attributes to a stamp tax, as that term is commonly understood: the tax must be paid prior to recordation and the amount due is generally governed by the consideration provided in the instrument.

The common meaning of the term "stamp tax" can also be ascertained by examining the attributes of typical stamp taxes. We therefore agree with the district court insofar as it identified several of the essential attributes of a stamp tax, in reliance on *Lee v. Bickell*, 292 U.S. 415, 417 (1934) and *Texaco, Inc. v. United States*, 624 F.2d 20, 21-22 (5th Cir. 1980). According to the district court, all stamp taxes (1) are imposed only at the time of transfer or sale of the item at issue; (2) impose an amount due that is determined by the consideration recited in the instrument of transfer; and (3) must be paid as a prerequisite to recording.

Based on the characteristics of several taxes that would undoubtedly be considered a "stamp tax or similar tax" within the meaning of § 1146(c), we believe there are several additional essential elements of all such taxes. One such element is that the tax rate, imposed by a stamp or similar tax, is a relatively small percentage of the consideration for the underlying transfer. We first consider the stamp taxes discussed in the federal cases relied upon by the district court. The Florida documentary stamp tax at issue in *Lee v. Bickell*, 292 U.S. 415 (1934), imposed a tax on the sale and transfer of securities of 10 cents on each $100.00 of par or face value. *See Lee* at 418 n.*. Effectively, this Florida tax imposed a tax rate of 1/10 of one percent of par or face value. In *Texaco, Inc. v. United States*, 624 F.2d 20, 21 (5th Cir. 1980), the documentary stamp tax that the taxpayers sought to avoid, section 4361 of the Internal Revenue Code of 1954, ch.736, § 4361,

68A Stat. 3, 520 (1954) (repealed in 1968) imposed a tax on the sale or transfer of realty of approximately 55 cents per $500 of consideration or value of the property interest. The resultant tax rate was slightly more than 1/10 of one percent of the consideration or value.[4]

Like the low rates imposed by these two stamp taxes, several modern state documentary transfer taxes, which we regard as similar to stamp taxes, also impose low tax rates. Vermont has a property transfer tax, Vt. Stat. Ann. tit. 32, § 9602 (1981), imposed on the transfer of real property by deed, at a rate of 5/10 of one percent of the value of the property. The tax is imposed when the deed is delivered to the town clerk for recording, Vt. Stat. Ann. tit. 32, § 9605 (1981), and compliance with the provisions of the property transfer tax is a prerequisite to recording. Vt. Stat. Ann. tit. 32, § 9608 (Supp. 1991). Connecticut terms its property transfer tax the Real Estate Conveyance Tax. Conn. Gen. Stat. Ann. § 12-494 (West Supp. 1991). The tax rate ranges from 55/100 of one percent up to 1 percent of the consideration depending on whether the property is residential and whether its value exceeds $800,000. *Id.* The transferor is liable for the tax, Conn. Gen. Stat. Ann. § 12-495 (West 1983), and deeds subject to the tax can not be recorded unless the tax is paid. Conn. Gen. Stat. Ann. § 12-497 (West Supp. 1991). New York has a similar tax, the Real Estate Transfer Tax, N.Y. Tax Law § 1402 & 1402-a (McKinney Supp. 1992). It imposes a tax on deeds of $2 for every $500 of consideration or

4 Note that this tax provision, § 4361, contains a cross-reference to section 4382 of the Internal Revenue Code of 1954. Section 4382, an exemption provision, refers to the Bankruptcy Act, largely tracks the language of § 267, and exempts debtors from this stamp tax on transactions undertaken pursuant to a plan of reorganization. Thus, the stamp tax imposed by § 4361 certainly was a stamp tax from which Congress intended qualified debtors to be exempt.

value, yielding a tax rate of 4/10 of one percent. N.Y. Tax Law § 1402 (McKinney Supp. 1992). Like the other documentary transfer taxes, the transfer tax must be paid prior to recordation. N.Y. Tax Law § 1410(b) (McKinney Supp. 1992). The grantor is liable for payment of the tax, but if he fails to pay it the grantee becomes liable. N.Y. Tax Law § 1404(a) (McKinney Supp. 1992). The New York scheme also imposes an additional tax on the conveyance of residential property when the consideration is $1 million or more at one percent of the consideration; the grantee is generally liable for this additional tax. N.Y. Tax Law § 1402-a (McKinney Supp. 1992). The foregoing examples of stamp and documentary transfer taxes show that an essential characteristic of these taxes is that they are calculated using a low tax rate—typically about one percent or less—multiplied by either the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction.[5]

Finally, we add one more essential characteristic of stamp taxes to those identified by the district court. As stated in *In re Jacoby-Bender, Inc.*, 40 B.R. 10, 15 (Bankr. E.D.N.Y. 1984), where the bankruptcy court held that the New York gains tax is not a stamp or similar tax within the meaning of 11 U.S.C. 1146(c), stamp taxes are imposed irrespective of whether the transfer resulted in a gain or loss to the transferor. All of the stamp taxes and real estate transfer taxes discussed above never even touch on whether the underlying transaction resulted in a gain or loss to the transferor.

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5 We note that this analysis is consistent with our decision in *In re Jacoby-Bender, Inc.*, 758 F.2d 840 (2d Cir. 1985), in which we found that 11 U.S.C. § 1146(c) (1982) exempted the debtor from payment of the New York City Real Property Transfer Tax, New York, N.Y. Admin. Code § II46-2.0 (1984); at that time the New York City tax imposed a maximum tax rate of two percent.

In sum, we believe that all stamp or similar taxes as stated in 11 U.S.C. § 1146(c) share the following common elements: (1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is determined by the consideration for, par value of, or value of the item being transferred; (3) the tax rate is a relatively small percentage of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state documentary transfer taxes, the tax must be paid as a prerequisite to recording. We next turn to the New York gains tax to determine whether it shares those attributes common to all stamp or similar taxes.

B.

Section 1441, contained in Article 31-B of New York Tax Law provides:

> A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain.

N.Y. Tax Law § 1441 (McKinney 1987). Gain is defined for the purposes of Article 31-B as:

> the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price.

N.Y. Tax Law § 1440.3 (McKinney 1987). Under the version of the statute in force at the time of the sale of the Stanhope Hotel, the transferor was required to pay the tax

on the date of transfer.[6] N.Y. Tax Law § 1442 (McKinney 1987). Transactions that are exempt from the tax include those for which the consideration is less than one million dollars and those in which the real property that is the subject of the transfer is the residence of the transferor. N.Y. Tax Law § 1443 (McKinney 1987 & Supp. 1992). Under N.Y. Tax Law § 1447.1(f)(1) (McKinney 1987), recording is prohibited unless the ministerial requirements of the act have been complied with and any tax due has been paid. *See also* N.Y. Real Property Law § 333.1-f (McKinney 1987) (prohibiting recording officer from recording unless the provisions of § 1447.1(f) are satisfied).

Our analysis of the essential characteristics of stamp or similar taxes indicates that although the New York gains tax bears some resemblance to a stamp tax, it is not a stamp or similar tax within the meaning of 11 U.S.C § 1146(a). As Fifth Avenue correctly points out, like a stamp tax, the gains tax is imposed at the time of transfer and payment, if due, must be made prior to recordation. But there the resemblance ends.

First, and most important, New York gains tax liability is always contingent on the profitability of the underlying transaction. If the transaction yields no gain, there is no tax due. The fact that "gain," as calculated under the gains tax, does not take into account certain development costs in no way alters this core attribute of the gains tax. Stamp taxes and documentary transfer taxes, by contrast, are always imposed irrespective of the existence of gain or profit; the tax liability arises solely from the act of transferring property or securities.

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6 The specifics regarding payment of and liability for the tax have since been somewhat modified. *See* N.Y. Tax Law §§ 1440.9, 1442(a) & 1447.3(a) (McKinney 1987 & Supp. 1992).

Second, under the gains tax, the consideration for the sale (or some proxy thereof as set forth in N.Y. Tax Law § 1440 (McKinney 1987 & Supp. 1992)) is not determinative of the amount due under the gains tax. Instead, the consideration is used only as a means to measure the gain accruing to the transferor as a result of the transfer. It is the gain, albeit as defined by the provisions of the gains tax, that provides the key figure for determination of the amount owed under the tax. The amount due under a stamp or similar tax hinges on the consideration for the transferred item.

Third, the tax rate provided in the New York gains tax, at 10 percent of the gain, greatly exceeds the tax rate used in any stamp tax or documentary transfer tax. Stamp and documentary transfer taxes impose a low tax rate, typically about one percent or less of the consideration for the underlying transfer. These three important differences between the New York gains tax and stamp and documentary transfer taxes lead us to conclude that the New York gains tax is not a "stamp tax or similar tax" within the meaning of 11 U.S.C § 1146(c).

Finally, we note that Fifth Avenue provides several rationales in support of its contention that the gains tax cannot be characterized as an income tax. For example, Fifth Avenue reasons that the gains tax is not a form of income tax because it does not allow a taxpayer to offset losses against gains in calculating net income generated by transactions completed over a specific period of time. This contention, however, misses the point: the relevant issue is not whether the gains tax can be pigeonholed as an income tax, but whether it represents a stamp or similar tax within the meaning of § 1146(c). For the reasons set forth above, we believe it does not and thus Fifth Avenue is not entitled to an exemption from the New York

gains tax. Thus, we reverse the order of the district court insofar as it directed New York to refund gains tax paid by Fifth Avenue.

Affirmed in part and reversed in part.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 416—August Term, 1991

(Argued October 28, 1991 Decided April 13, 1992)

Docket No. 91-5038

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiff-Appellee,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, as Commissioner of Taxation and Finance; EDWARD V. REGAN, as Comptroller of the State of New York,

Defendants-Appellants.

Before:

OAKES, *Chief Judge*,
FEINBERG and ALTIMARI, *Circuit Judges*.

The New York State Department of Taxation and Finance, James W. Wetzler, as New York Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York, appeal from an order of the United States District Court for the Southern District of New York (Leonard B. Sand, *Judge*) affirming the opinion and order of the Bankruptcy Court (Tina L. Brozman, *Bankruptcy Court Judge*). The Bankruptcy Court granted 995 Fifth Avenue Associates, L.P.'s motion for summary judgment and ordered the New York State Department of Taxation and Finance to refund New York Gains Tax, N.Y. Tax Law § 1441 (McKinney 1987) paid by 995 Fifth Avenue Associates, L.P.

Affirmed in part and reversed in part.

DAVID S. COOK, Senior Attorney, Attorney General's Office, State of New York, New York, NY (Robert Abrams, Attorney General, Frederic L. Lieberman, Marcie S. Mintz, Assistant Attorneys General, of counsel), *for Defendants-Appellants*.

JOSHUA J. ANGEL, New York, NY (Leonard H. Gerson, Ira R. Abel, Angel & Frankel, P.C., of counsel), *for Plaintiff-Appellee*.

OAKES, *Chief Judge*:

This appeal requires us to decide whether the Eleventh Amendment bars a debtor's suit to recover taxes paid to the State of New York, and whether 11 U.S.C. § 1146(c)

(1988) exempts the debtor from payment of the New York gains tax on the transfer of property, N.Y. Tax Law § 1441 (McKinney 1987). The United States Bankruptcy Court for the Southern District of New York, Tina L. Brozman, *Bankruptcy Court Judge*, found that the New York State Department of Taxation and Finance, James W. Wetzler, as New York Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York (collectively "State of New York," "New York," or "appellant") waived the State of New York's immunity from suit by filing a proof of claim in the bankruptcy proceeding, found that the debtor was exempt from the gains tax, and accordingly ordered New York to refund the gains tax paid by the debtor, 995 Fifth Avenue Associates, L.P. ("Fifth Avenue"). New York appealed to the United States District Court for the Southern District of New York. Leonard B. Sand, *District Judge*, affirmed the opinion and order of the bankruptcy court and the State of New York now appeals.

For the reasons set forth below, we affirm in part and reverse in part.

BACKGROUND

The relevant facts are not in dispute. The debtor, Fifth Avenue, operated the Stanhope Hotel. It filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code in February of 1988 and thereafter continued to operate the hotel as debtor in possession. Pursuant to a plan of reorganization, the bankruptcy court authorized the sale of Fifth Avenue's interest in the hotel at a price of $76 million. The court's order specifically declared that, because the sale was part of a plan of reorganization, § 1146(c) rendered the sale exempt from all transfer taxes.

On January 12, 1989, the day before the scheduled closing, in accordance with N. Y. Tax Law § 1447 (McKinney 1987), New York issued a Tentative Assessment and Return imposing a gains tax of $2,608,603.80 on the sale of the property. New York subsequently denied the debtor's request for an exemption from the tax under 11 U.S.C. § 1146(c). Because New York law prohibits recordation of the deed without payment of tax due under a Tentative Assessment and Return, Fifth Avenue could not close the sale as scheduled without paying the gains tax. Faced with this dilemma, the debtor paid the tax under protest, enabling it to record the deed and close the sale.

In March 1989, the debtor brought an adversary proceeding in bankruptcy court against the State of New York, seeking, *inter alia*, a declaration that § 1146(c) exempted the debtor from the gains tax, and an order directing that the payment made to New York be refunded. Some months later, after the bankruptcy court heard oral argument in the proceeding, the State of New York filed an administrative expense claim for gains tax liability of $2,137,496.76, an amount in addition to the approximately $2.6 million already imposed by the state and paid by the debtor.

The bankruptcy court found that the debtor's sale was exempt from the gains tax under § 1146(c). In response to the State of New York's Eleventh Amendment immunity argument, the bankruptcy court held that pursuant to 11 U.S.C. § 106(a) (1988), New York had waived its Eleventh Amendment immunity by filing the administrative expense claim for additional gains tax. The district court affirmed the decision and order of the bankruptcy court.

DISCUSSION

I. Eleventh Amendment Immunity

Appellant argues that the Eleventh Amendment barred both the bankruptcy court and the district court from considering whether the debtor was exempt from payment of the New York gains tax. The Eleventh Amendment, where applicable, deprives a federal court of jurisdiction. *See Edelman v. Jordan*, 415 U.S. 651, 678 (1974). Thus, prior to addressing the merits of this case we must first determine whether Eleventh Amendment immunity bars our jurisdiction. We hold that it does not.

The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

The reach of the amendment was judicially expanded beyond its text in *Hans v. Louisiana*, 134 U.S. 1 (1890), to bar citizens from suing their own states in federal court. The Supreme Court has also consistently held that federal suits by private citizens that seek damages to be paid out of the state treasury are barred by the Eleventh Amendment. *See, e.g., Quern v. Jordan*, 440 U.S. 332, 337 (1979).

Despite this general bar to suits against states created by the Eleventh Amendment, there are two well-established ways to provide judicial power over such cases: abrogation of immunity by Congress and waiver of immunity by a state. *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 99 (1984). A purported Con-

gressional abrogation of Eleventh Amendment immunity is not effective, however, unless it meets a two-part test set forth by the Court. First, Congress must make its intent to abrogate Eleventh Amendment immunity "unmistakably clear." *Pennsylvania v. Union Gas Co.*, 491 U.S. 1, 7 (1989) (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985)). Second, the constitutional provision under which Congress legislates its purported abrogation must grant Congress the power to override the Eleventh Amendment. *Union Gas*, 491 U.S. at 13-23. Abrogation of Eleventh Amendment immunity typically occurs when Congress enacts a new federal statutory cause of action. *See, e.g. Fitzpatrick v. Bitzer*, 427 U.S. 445, 456 (1976) (Eleventh Amendment immunity abrogated for suit to recover damages from the State for gender-based employment discrimination under Title VII); *Union Gas Co.*, 491 U.S. at 23 (Eleventh Amendment immunity abrogated for suit to recover costs from the State for environmental clean-up under CERCLA).

Waiver of Eleventh Amendment immunity, in contrast to abrogation, is not hinged to a specific federal statutory cause of action. Instead, it is triggered by some affirmative activity of a state, such as a state's enactment of legislation by which it consents to be sued in federal court, *see, e.g., Port Auth. Trans-Hudson Corp. v. Feeney*, 495 U.S. 299, 307-09 (1990), and, as here, a state's participation in litigation in federal court. In *Clark v. Barnard*, 108 U.S. 436, 447-48 (1883), for example, the State of Rhode Island was deemed to have waived its Eleventh Amendment immunity by intervening in a case as a claimant of a fund. And the Court in *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947), held that where the State of New Jersey filed a claim against a fund in bankruptcy court, in a case where no judgment was sought against the

State, the State waived its immunity. Thus, as the district court noted, it is long-established that a state's participation in a bankruptcy proceeding can trigger a waiver of immunity.

The State of New York does not take issue with this general principle. Rather, it argues that the provision of the Bankruptcy Code under which the bankruptcy court deemed the State to have waived its Eleventh Amendment immunity—11 U.S.C. § 106(a)—represents an abrogation provision, not a waiver scheme. As an abrogation provision, New York contends, § 106(a) is unconstitutional because Congress lacks the authority to abrogate sovereign immunity when enacting legislation under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4. We disagree with New York's characterization of § 106(a).

Section 106(a) provides:

> A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

The plain meaning of these words obviously reflects Congress's intent to provide a *waiver* of immunity where "a governmental unit" files a claim in the bankruptcy court. The scope of the waiver, of course, remains limited; upon filing a claim the governmental unit subjects itself only to claims that arose from the same transaction or occurrence that formed the basis of the governmental unit's claim. Our conclusion derives further support from two recent cases where the Supreme Court, albeit in dicta, stated that § 106(a) provides for a limited waiver of immunity. *See Hoffman v. Connecticut Income Maint.*

Dept., 492 U.S. 96, 101-02 (1989); *U.S. v. Nordic Village, Inc.*, No. 90-1629, slip op. at 4-6 (U.S. Feb. 25, 1992).

In addition, Congress did not use the language of abrogation in § 106(a). Compare, for example, the language used by Congress in *Union Gas*, where the Court held that Congress abrogated Eleventh Amendment immunity in making states liable for cleanup costs under CERCLA. *Union Gas*, 491 U.S. at 13. In the provisions there at issue, Congress stated that any "person," "owner[,] and operator" shall be liable. 42 U.S.C. § 9607(a) (1988). Congress went on to include states in the definition of a "person," 42 U.S.C. § 9601(21), and except in very limited situations Congress provided that states fall within the meaning of the term "owner or operator." *See* 42 U.S.C. § 9601(20)(D). Thus, CERCLA contains the language of abrogation by clearly stating that states can be liable for cleanup costs. Section 106(a) contains no similar statement regarding the liability of states for a specific class of damages.

Not only is the wording of § 106(a) different from language aimed at a general override of immunity, but this provision provides for suits against states by a route that differs markedly from the typical abrogation context. Typically, abrogation occurs when Congress has enacted a cause of action generally and seeks to render states, in particular, liable for damages "along with everyone else." *Union Gas*, 491 U.S. at 8. Section 106(a), however, renders a state liable to suit only when the state participates in a bankruptcy proceeding by filing a claim.

Thus, § 106(a) creates a waiver scheme; it is not an abrogation provision. Indeed, the section largely partakes of the waiver by participation doctrine that received the Supreme Court's imprimatur in *Gardner*, 329 U.S. at 574.

Because we find that § 106(a) specifies when a state has waived its Eleventh Amendment immunity, we need not address appellant's contention that Congress lacks the authority to abrogate sovereign immunity when enacting legislation under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4.

Next, we consider the validity of the purported waiver of Eleventh Amendment immunity under § 106(a). We note at the outset that, like the First Circuit, we see no constitutional barrier to a waiver of Eleventh Amendment immunity as provided in § 106(a). In *WJM, Inc. v. Massachusetts Dept. of Public Welfare*, 840 F.2d 996, 1002-005 (1st Cir. 1988), the court held that Congress possesses the authority to condition a state's participation in a bankruptcy proceeding on its waiver of Eleventh Amendment immunity. The court in *WJM* relied in part on *Atascadero*, where the Court considered whether states can be sued for damages under a Congressionally-created cause of action. In *Atascadero*, the Court determined that the Congressional legislation in question fell "far short of manifesting a clear intent to condition participation in the programs funded under the Act on a State's consent to waive its constitutional immunity." *Atascadero*, 473 U.S. at 247. After citing this language, the *WJM* court reasoned:

> The logical inference from this and other language in *Atascadero*, however, is that Congress *may* effectively condition a state's participation in a federal program on a state's consent to federal jurisdiction, so long as Congress manifests a clear intent to this effect.

WJM, 840 F.2d at 1003. We agree with the First Circuit's analysis.

Our conclusion regarding Congressional authority, however, does not end the inquiry, because we will only give effect to Congressional legislation that purports to condition state participation in litigation on a state's waiver of Eleventh Amendment immunity when Congress "manifest[s] a clear intent" to do so. *Atascadero*, 473 U.S. at 247. This requirement is analogous to the test the Court applies to determine the validity of a state's waiver of Eleventh Amendment immunity by state legislation. In that context, "[t]he Court will give effect to a State's waiver of Eleventh Amendment immunity 'only where stated by the most express language or by such overwhelming implication from the text as [will] leave no room for any other reasonable construction.' " *Feeney*, 495 U.S. at 299 (quoting *Atascadero*, 473 U.S. at 239-40 and *Edelman*, 415 U.S. at 673). We discern no substantive difference between the test for a Congressional waiver scheme, as set forth in *Atascadero*, and the test for a waiver by state legislation, as applied in *Feeney*. Thus, we must again turn to the language of § 106(a) to determine whether it plainly requires a waiver of Eleventh Amendment immunity and "leave[s] no room for any other reasonable construction." *Atascadero*, 473 U.S. at 240.

Appellant argues that no such waiver of Eleventh Amendment immunity is implicated by § 106(a) because, by its terms, it fails to mention the Eleventh Amendment. Explicit mention of the Eleventh Amendment, however, has never been a requirement for waiver of immunity. For example, in *Feeney*, the Court found that by statute the states of New York and New Jersey had waived their Eleventh Amendment immunity, but nowhere did the statutory provisions mention the Eleventh Amendment. *Feeney*, 495 U.S. at 303, 306-09. *See also Dellmuth v. Muth*, 491 U.S. 223, 233 (1989) (Scalia, *J.*, concurring)

(statutory text may override Eleventh Amendment immunity without explicit reference to either state sovereign immunity or the Eleventh Amendment). Similarly, the text's failure specifically to mention states is irrelevant: § 106(a) uses the term "governmental unit," which the Bankruptcy Code defines in 11 U.S.C. § 101(26) (1988) as including a "State." To hold otherwise would ignore the fact that Congress routinely expresses its intent with statutes drafted with definitional cross-references.[1] Accordingly, we find that § 106(a) plainly expresses Congress's intent to provide for a limited waiver of Eleventh Amendment immunity and "leave[s] no room for any other reasonable construction." *Atascadero*, 473 U.S. at 240.

Applying § 106(a) to the facts of this case, we find that the State of New York, by filing an administrative expense claim for $2,137,496.76, waived its Eleventh Amendment immunity with respect to the $2,608,603.80 million in gains tax paid by the debtor. As we have stated, § 106(a) provides for waiver of Eleventh Amendment immunity from any claim against the state "that arose out of the same transaction or occurrence out of which such governmental unit's claim arose." Here, the State's administrative expense claim arose from additional gains tax levied on the sale of the Stanhope Hotel. Fifth Avenue's claim against the State for a refund also arose from gains tax imposed on the sale of the Stanhope Hotel. Thus, appellee's claim for a tax refund arose from the same transaction or occurrence—the sale of the Stanhope Hotel—as the State's claim for additional taxes. Accord-

1 The State of New York also argues that § 106(a) is insufficiently clear because it does not mention the filing of a proof of claim. We do not believe this fact renders Congress's intent unclear, because the only reasonable construction of § 106(a) is that waiver will arise only if a claim is actually filed.

ingly, the Eleventh Amendment does not bar us from reaching the merits of this case.

II. Whether the Gains Tax is a "Stamp Tax or Similar Tax"

We now consider whether the New York gains tax, N.Y. Tax Law § 1441 (McKinney 1987), is a "stamp tax or similar tax" within the meaning of 11 U.S.C. § 1146(c). Because the New York gains tax is not a "stamp tax or similar tax," we hold that 995 Fifth Avenue is not entitled to an exemption from the gains tax.

A.

We begin our discussion with an analysis of the type of taxes from which Congress intended to exempt qualifying debtors when it enacted 11 U.S.C. § 1146(c). Starting with the text, section 1146(c) provides:

> The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

The Bankruptcy Code supplies no definitions for the terms "stamp tax" or "similar tax." Thus, we must look to the legislative history for assistance in determining what Congress meant by the phrase "stamp tax or similar tax." This history, however, provides limited guidance.

Section 1146(c), enacted as part of Title 11 and the general revision of the federal bankruptcy laws in 1978, was derived from § 267 of the Bankruptcy Act of 1898, as amended by the Chandler Act of 1938, ch. 575, § 267, 52

Stat. 840, 902-03 (1938) (repealed in 1979). In essence, the new provision broadened the scope of the exemption to include taxes "similar" to stamp taxes: whereas § 267 exempted the debtor from "any stamp taxes now or hereafter imposed," § 1146(c) provides exemption from "any law imposing a stamp tax *or similar tax*" (emphasis added).[2] The legislative history surrounding the enactment of § 1146(c) does not illuminate what Congress meant when it added the words "or similar tax."

Similarly, there is no relevant legislative history to shed light on Congressional intent behind the enactment of the earlier exemption provision, § 267, which was part of the Chandler Act of 1938. Section 267 greatly changed the wording of its precursor provision, § 77B(f) of the Bankruptcy Act, as amended by the Act of June 7, 1934, ch. 424, § 77B(f), 48 Stat. 911, 919 (1934) (amended in 1938). Section 267 used general language to expand an exemption that had shielded qualified debtors from federal stamp taxes only into one that shielded such debtors from state stamp taxes as well. *See* 11 Harold Remington, A Treatise on the Bankruptcy Law of the United States § 4654 (Kenneth A. Hayes, ed., rev. 1961).

Section 77B(f), the original source of the stamp tax exemption, was added to the Bankruptcy Act by the Act of June 7, 1934, and represented Congress's first effort to provide for the reorganization of corporations in

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2 The report of the House Judiciary Committee stated that "[s]ection 1146(c) of title 11 broadens the exemption to any stamp or similar tax." H.R. Rep. No. 595, 95th Cong., 1st Sess. 281 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6238. We disagree with the district court to the extent it concluded that this statement reflects Congress's intent that the words "stamp or similar tax" be read broadly to accord greater tax relief for debtors. Instead, we regard this statement as a simple declaration that the new provision, § 1146(c), enlarges the former exemption under § 267 to include taxes similar to stamp taxes.

bankruptcy. 1 Harold Remington & James A. Henderson, A Treatise on the Bankruptcy Law of the United States § 10 (5th ed. 1950). By its terms, § 77B(f) provided debtors with exemptions from only specific federal stamp taxes on the issuance and transfer of stock and bonds and on conveyances of realty. One of the purposes of § 77B(f) was to exempt the debtor from the payment of federal stamp tax on new securities issued pursuant to a plan of reorganization that required the debtor to modify the terms of outstanding securities for which stamp tax had already been paid.[3] *See* S. Rep. No. 482, 73rd Cong., 2d Sess. 4 (1934). In sum, although the legislative history shows that the scope of the § 1146(c) tax exemption has expanded since its original enactment in 1934, it fails to indicate whether the New York gains tax qualifies as a "stamp tax or similar tax."

Absent more explicit guidance from either the text or the legislative history, we must interpret the words used by Congress in accordance with "their ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). Dictionaries represent one source of such common meaning. *See, e.g., United States v. Adames*, 901 F.2d 11, 12 (2d Cir. 1990). Black's Law Dictionary 1259 (5th ed. 1979) defines "stamp tax" as the "cost of stamps which are required to be affixed to legal documents such as deeds, certificates, and the like." The definition also contains a cross-reference to "[d]ocumentary stamp," which Black's defines as "[s]tamp required by federal (prior to 1968) and state law to be affixed to deeds and other documents of transfer before they may be recorded, the cost of which is generally gov-

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3 These stamp taxes were repealed by the Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, § 401(b), 79 Stat. 148 (1965), effective January 1, 1968.

erned by the consideration recited in the document." This definition indicates that there are at least two attributes to a stamp tax, as that term is commonly understood: the tax must be paid prior to recordation and the amount due is generally governed by the consideration provided in the instrument.

The common meaning of the term "stamp tax" can also be ascertained by examining the attributes of typical stamp taxes. We therefore agree with the district court insofar as it identified several of the essential attributes of a stamp tax, in reliance on *Lee v. Bickell*, 292 U.S. 415, 417 (1934) and *Texaco, Inc. v. United States*, 624 F.2d 20, 21-22 (5th Cir. 1980). According to the district court, all stamp taxes (1) are imposed only at the time of transfer or sale of the item at issue; (2) impose an amount due that is determined by the consideration recited in the instrument of transfer; and (3) must be paid as a prerequisite to recording.

Based on the characteristics of several taxes that would undoubtedly be considered a "stamp tax or similar tax" within the meaning of § 1146(c), we believe there are several additional essential elements of all such taxes. One such element is that the tax rate, imposed by a stamp or similar tax, is one percent or even less of the consideration for the underlying transfer. We first consider the stamp taxes discussed in the federal cases relied upon by the district court. The Florida documentary stamp tax at issue in *Lee v. Bickel*, 292 U.S. 415 (1934), imposed a tax on the sale and transfer of securities of 10 cents on each $100.00 of par or face value. *See Lee* at 418 n. *. Effectively, this Florida tax imposed a tax rate of 1/10 of one percent of par or face value. In *Texaco, Inc. v. United States*, 624 F.2d 20, 21 (5th Cir. 1980), the documentary stamp tax that the taxpayers sought to avoid, section 4361

of the Internal Revenue Code of 1954, ch.736, § 4361, 68A Stat. 3, 520 (1954) (repealed in 1968) imposed a tax on the sale or transfer of realty of approximately 55 cents per $500 of consideration or value of the property interest. The resultant tax rate was slightly more than 1/10 of one percent of the consideration or value.[4]

Like the low rates imposed by these two stamp taxes, several modern state documentary transfer taxes, which we regard as similar to stamp taxes, also impose low tax rates. Vermont has a property transfer tax, Vt. Stat. Ann. tit. 32, § 9602 (1981), imposed on the transfer of real property by deed, at a rate of 5/10 of one percent of the value of the property. The tax is imposed when the deed is delivered to the town clerk for recording, Vt. Stat. Ann. tit. 32, § 9605 (1981), and compliance with the provisions of the property transfer tax is a prerequisite to recording. Vt. Stat. Ann. tit. 32, § 9608 (Supp. 1991). Connecticut terms its property transfer tax the Real Estate Conveyance Tax. Conn. Gen. Stat. Ann. § 12-494 (West Supp. 1991). The tax rate ranges from 55/100 of one percent up to 1 percent of the consideration depending on whether the property is residential and whether its value exceeds $800,000. *Id.* The transferor is liable for the tax, Conn. Gen. Stat. Ann. § 12-495 (West 1983), and deeds subject to the tax can not be recorded unless the tax is paid. Conn. Gen. Stat. Ann. § 12-497 (West Supp. 1991). New York has a similar tax, the Real Estate Transfer Tax, N.Y. Tax Law § 1402 & 1402-a (McKinney Supp. 1992). It imposes

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4 Note that this tax provision, § 4361, contains a cross-reference to section 4382 of the Internal Revenue Code of 1954. Section 4382, an exemption provision, refers to the Bankruptcy Act, largely tracks the language of § 267, and exempts debtors from this stamp tax on transactions undertaken pursuant to a plan of reorganization. Thus, the stamp tax imposed by § 4361 certainly was a stamp tax from which Congress intended qualified debtors to be exempt.

a tax on deeds of $2 for every $500 of consideration or value, yielding a tax rate of 4/10 of one percent. N.Y. Tax Law § 1402 (McKinney Supp. 1992). Like the other documentary transfer taxes, the transfer tax must be paid prior to recordation. N.Y. Tax Law § 1410(b) (McKinney Supp. 1992). The grantor is liable for payment of the tax, but if he fails to pay it the grantee becomes liable. N.Y. Tax Law § 1404(a) (McKinney Supp. 1992). The New York scheme also imposes an additional tax on the conveyance of residential property when the consideration is $1 million or more at one percent of the consideration; the grantee is generally liable for this additional tax. N.Y. Tax Law § 1402-a (McKinney Supp. 1992). The foregoing examples of stamp and documentary transfer taxes show that an essential characteristic of these taxes is that they are calculated using a low tax rate of about one percent or less, multiplied by either the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction.

Finally, we add one more essential characteristic of stamp taxes to those identified by the district court. As stated in *In re Jacoby-Bender, Inc.*, 40 B.R. 10, 15 (Bankr. E.D.N.Y. 1984), where the bankruptcy court held that the New York gains tax is not a stamp or similar tax within the meaning of 11 U.S.C. 1146(c), stamp taxes are imposed irrespective of whether the transfer resulted in a gain or loss to the transferor. All of the stamp taxes and real estate transfer taxes discussed above never even touch on whether the underlying transaction resulted in a gain or loss to the transferor.

In sum, we believe that all stamp or similar taxes as stated in 11 U.S.C. § 1146(c) share the following common elements: (1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is

determined by the consideration for, par value of, or value of the item being transferred; (3) the tax rate is relatively low—about one percent or less of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state documentary transfer taxes, the tax must be paid as a prerequisite to recording. We next turn to the New York gains tax to determine whether it shares those attributes common to all stamp or similar taxes.

B.

Section 1441, contained in Article 31-B of New York Tax Law provides:

> A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain.

N.Y. Tax Law § 1441 (McKinney 1987). Gain is defined for the purposes of Article 31-B as:

> the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price.

N.Y. Tax Law § 1440.3 (McKinney 1987). Under the version of the statute in force at the time of the sale of the Stanhope Hotel, the transferor was required to pay the tax on the date of transfer.[5] N.Y. Tax Law § 1442 (McKinney 1987). Transactions that are exempt from the tax include those for which the consideration is less than one million

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5 The specifics regarding payment of and liability for the tax have since been somewhat modified. *See* N.Y. Tax Law §§ 1440.9, 1442(a) & 1447.3(a) (McKinney 1987 & Supp. 1992).

dollars and those in which the real property that is the subject of the transfer is the residence of the transferor. N.Y. Tax Law § 1443 (McKinney 1987 & Supp. 1992). Under N.Y. Tax Law § 1447.1(f)(1) (McKinney 1987), recording is prohibited unless the ministerial requirements of the act have been complied with and any tax due has been paid. *See also* N.Y. Real Property Law § 333.1-f (McKinney 1987) (prohibiting recording officer from recording unless the provisions of § 1447.1(f) are satisfied).

Our analysis of the essential characteristics of stamp or similar taxes indicates that although the New York gains tax bears some resemblance to a stamp tax, it is not a stamp or similar tax within the meaning of 11 U.S.C § 1146(a). As Fifth Avenue correctly points out, like a stamp tax, the gains tax is imposed at the time of transfer and payment, if due, must be made prior to recordation. But there the resemblance ends.

First, and most important, New York gains tax liability is always contingent on the profitability of the underlying transaction. If the transaction yields no gain, there is no tax due. The fact that "gain," as calculated under the gains tax, does not take into account certain development costs in no way alters this core attribute of the gains tax. Stamp taxes and documentary transfer taxes, by contrast, are always imposed irrespective of the existence of gain or profit; the tax liability arises solely from the act of transferring property or securities.

Second, under the gains tax, the consideration for the sale (or some proxy thereof as set forth in N.Y. Tax Law § 1440 (McKinney 1987 & Supp. 1992)) is not determinative of the amount due under the gains tax. Instead, the consideration is used only as a means to measure the gain

accruing to the transferor as a result of the transfer. It is the gain, albeit as defined by the provisions of the gains tax, that provides the key figure for determination of the amount owed under the tax. The amount due under a stamp or similar tax hinges on the consideration for the transferred item.

Third, the tax rate provided in the New York gains tax, at 10 percent of the gain, greatly exceeds the tax rate used in any stamp tax or documentary transfer tax. Stamp and documentary transfer taxes impose a tax rate of about one percent or less of the consideration for the underlying transfer. These three important differences between the New York gains tax and stamp and documentary transfer taxes lead us to conclude that the New York gains tax is not a "stamp tax or similar tax" within the meaning of 11 U.S.C § 1146(c).

Finally, we note that Fifth Avenue provides several rationales in support of its contention that the gains tax cannot be characterized as an income tax. For example, Fifth Avenue reasons that the gains tax is not a form of income tax because it does not allow a taxpayer to offset losses against gains in calculating net income generated by transactions completed over a specific period of time. This contention, however, misses the point: the relevant issue is not whether the gains tax can be pigeonholed as an income tax, but whether it represents a stamp or similar tax within the meaning of § 1146(c). For the reasons set forth above, we believe it does not and thus Fifth Avenue is not entitled to an exemption from the New York gains tax. Thus, we reverse the order of the district court insofar as it directed New York to refund gains tax paid by Fifth Avenue.

Affirmed in part and reversed in part.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No: 91-5038

FILED APRIL 13, 1992

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 13th day of April, one thousand nine hundred and ninety-two.

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

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995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiff-Appellee,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, as Commissioner of Taxation and Finance; EDWARD V. REGAN, as Comptroller of the State of New York,

Defendants-Appellants.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the order of said district court be and it hereby is affirmed in part, reversed in part in accordance with the opinion of this court.

ELAINE B. GOLDSMITH, *Clerk*
By:

/s/ EDWARD J. GUARDARO
Edward J. Guardaro
Staff Attorney

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

90 Civ. 5744 (LBS)

May 16, 1991

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiffs-Appellees,

—against—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, JAMES W. WETZLER as Commissioner of Taxation and Finance, and EDWARD V. REGAN as Comptroller of the State of New York,

Defendants-Appellants.

Angel & Frankel, P.C., New York City (Joshua J. Angel, Leonard H. Gerson, Ira R. Abel, of counsel), for plaintiffs-appellees.

Robert Abrams, Attorney General of the State of New York, New York City (Frederic L. Lieberman, David S. Cook, of counsel), for defendants-appellants.

OPINION

SAND, *District Judge*.

This case comes to this Court on appeal from an order of the United States Bankruptcy Court for the Southern District of New York, Hon. Tina L. Brozman. The New York State Department of Taxation and Finance, James W. Wetzler, New York Commissioner of Taxation and Finance and Edward W. Regan, Comptroller of the State of New York (collectively "Appellants") appeal from a decision and order granting the motion for summary judgment made by 995 Fifth Avenue Associates, L.P.'s ("Appellees"). Two issues are presented. First, as a jurisdictional matter, Appellants suggest that the Bankruptcy Court acted outside its powers since the relief granted was barred by the Eleventh Amendment and the doctrine of sovereign immunity. Second, Appellants claim that the Bankruptcy Court decision and order should be reversed as a matter of law for exempting Appellees, under provisions of the Bankruptcy Code, from the payment of certain New York State taxes.

The Bankruptcy Court held that the sale by Appellees of its interest in the Stanhope Hotel ("Stanhope") pursuant to a Chapter 11 plan is exempt, under section 1146(c) of Title 11 of the United States Code, 11 U.S.C. § 1146(c) (1988) ("Bankruptcy Code"), from a ten percent tax imposed on gains derived from the transfer of real property by Article 31-B § 1441 *et seq.* of the New York tax law ("Gains Tax"). The Bankruptcy Court directed Appellants to refund to Appellees the Gains Tax collected in the amount of $2,608,603.80 together with interest. The Bankruptcy Court further held that Appellants had waived their sovereign immunity and Eleventh Amendment rights with respect to all aspects of the Gains Tax through the filing of a proof of claim by the Commissioner of Taxation and Finance of the State of New York, which asserted a tax liability. For the reasons stated below, the decision and order of the Bankruptcy Court are affirmed.

I. FACTS

There is little disagreement on the facts in this case. The Appellees were in the business of operating a hotel and related restaurant and catering facilities known as the Stanhope. The Appellees filed a Chapter 11 petition on February 4, 1988 and continued operating the business as debtors-in-possession. Over the course of the bankruptcy case, the Appellees filed an original and three subsequent amended plans of reorganization (collectively, "the Plan"), all of which contemplated the sale of the Appellees' interest in the Stanhope. On July 20, 1989, the Bankruptcy Court approved the Plan. Shortly thereafter the Stanhope was sold and there was a distribution of funds to the creditors.[1]

Prior to approving the Plan, the Bankruptcy Court issued an order dated November 29, 1988 ("Sale Order"), authorizing the Appellees to sell or assign its interest in the Stanhope for the amount of $76,000,000. The Sale Order declared that the Sale was being made under a plan of reorganization and, pursuant to section 1146(c) of the Bankruptcy Code, would be exempt from any federal, state, or local transfer taxes. The closing of the sale was scheduled for January 13, 1989. On January 12, 1989, pursuant to the pre-transfer audit procedures provided by the New York Tax Law, Appellants issued a Tentative Assessment and Return ("first assessment") imposing a Gains Tax of $2,608,603.80 on the proposed sale and transfer. The Appellees immediately objected to, and were denied by Appellants a reprieve from, the proposed Gains Tax based on section 1146(c) of the Bankruptcy Code. Because state law prohibits recordation of title and transfer in local land records without payment of any tax due, the Appellees paid the Gain Tax under protest to allow the closing to go forward and the deed to be recorded. *See* N.Y. Tax Law § 1447(f) (McKinney 1987).[2]

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1 There are still some creditors who have yet to be paid under the Plan and any money deposited in Appellee's account as a result of this action will be distributed according to the Plan. *See* transcript of oral argument, dated February 21, 1991 ("tr") at p. 3.

2 In conformance with the Plan where a claim is objected to, as in the case of Appellant's claim, the monies at issue are placed in an escrow account maintained by the Appellees. *See* tr. at 3.

Since Appellees paid the exact amount of Gains Tax charged in the first assessment, Appellants did not file a proof of claim as to that amount. However, Appellants did file two other proofs of claim in the Bankruptcy Court. Appellants first filed a proof of claim on January 29, 1989 for approximately $3 million to recover sales and withholding taxes. None of these taxes are challenged in this action and are not relevant to the Gains Tax question. The second proof of claim, filed on October 23, 1989, which is the only claim at issue in this action, was designated the "Third Amended Administrative Expense Claim" ("Claim 300").[3] This claim is based in part on what the Appellants concluded is an additional Gains Tax liability of $2,137,496.76 over and above the $2,608,603.80 already imposed. Claim 300 was filed after the Bankruptcy Court heard oral argument on the summary judgment motion but before it issued an opinion.

II. DISCUSSION

A. *Eleventh Amendment and Sovereign Immunity*

Appellants allege as a threshold matter that the Eleventh Amendment and the doctrine of sovereign immunity bar the Bankruptcy Court, and this Court, from considering any portion of this case. Since these immunity defenses are jurisdictional in nature, the Court must first consider their validity. The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." At its core, this Amendment stands for the fundamental principle that "sovereign immunity limits the grant of judicial authority in Article III" of the Constitution. *Pennhurst State School & Hospital v. Halderman*, 465 U.S. 89, 98 (1984). Although not explicitly stated by the language in the

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3 An Administrative Expense Claim is a type of proof of claim which allows a creditor to move ahead of unsecured creditors to a first or second priority.

Amendment, it is a long standing rule that sovereign immunity also bars a citizen from bringing a suit against his or her own State in federal court. *See Hans v. Louisiana*, 134 U.S. 1 (1890).

There are, however, well established exceptions to the reach of the Eleventh Amendment and the doctrine of sovereign immunity. For example, the Supreme Court has held that if a State waives its immunity and consents to suit in a federal court, the Eleventh Amendment does not bar such an action. *See Clark v. Barnard*, 108 U.S. 436, 447 (1883).[4] A State may effectuate a waiver of its constitutional immunity by enacting a state statute or constitutional provision, "or by otherwise waiving its immunity to suit in the context of a particular federal program." *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 238 n. 1 (1985). Waiver by participation occurs when a State engages in a federally sponsored activity in which Congress has made waiver of immunity a pre-condition of state participation. *Id.* at 237. Still, any consent by the state to waive its Eleventh Amendment rights by participating in a federal program requires an unequivocal and clear indication of such an intention. *See Edelman v. Jordon*, 415 U.S. 651, 673 (1974).

The waiver of a State's immunity rights by participation in a bankruptcy proceeding has long been recognized, not only under the Bankruptcy Code, but also under the former Bankruptcy Act. *See Clark v. Barnard*, 108 U.S. 436, 447-48

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4 Another exception is waiver by abrogation. Congress may override Eleventh Amendment immunity by enacting a statute pursuant to its plenary powers granted by the Constitution. For example, Congress has the authority to abrogate a State's immunity pursuant to Section 5 of the Fourteenth Amendment. *See Fitzpatrick v. Bitzer*, 427 U.S. 445 (1976). Legislative power to abrogate is also available pursuant to Article I under the Commerce Clause. *See Pennsylvania v. Union Gas Co.*, ___ U.S. ___, 109 S. Ct. 2273, 2277 (1989). It is unclear whether Congress has the power under the Bankruptcy Clause of Article I to abrogate a State's immunity. In *Hoffman v. Connecticut Dep't of Income Maintenance*, ___ U.S. ___, 109 S. Ct. 2818, 2824 (1989), the Supreme Court declined to address the question since the case was resolved on other grounds. *Id.* at 2824. *See also Union Gas Co.*, 109 S. Ct. at 2277 (if statutory language does not contain clear expression of intent, constitutional questions of Congress's authority to abrogate immunity need not be considered).

(1883). As the Supreme Court has held, "[w]hen the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the claim." *Gardner v. New Jersey*, 329 U.S. 565, 574 (1946). In essence, if a State desires to participate in obtaining remaining assets from a bankrupt estate it is subject, as are all the interested parties, to the requirements imposed by the Bankruptcy Court such as bar dates for filing claims and sale orders.

This exception to the Eleventh Amendment and the doctrine of sovereign immunity was codified in section 106(a) of the Bankruptcy Code. Section 106 provides, in pertinent part:

> Waiver of sovereign immunity
>
> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occupance out of which such governmental unit's claim arose.

11 U.S.C. § 106(a) (1988).[5] In clear, concise language, Congress conditioned a state's participation in a specific federal program on the state's consent to federal jurisdiction. If a state chooses to enter the federal government's exclusive bankruptcy preserve—to assert a claim against a debtor's estate—it must file a proof of claim, as required of all parties.[6] *See Atascadero State Hospital v. Scanlon*, 473 U.S. 234 (1985). Section 106(a) puts the state on notice that the *quid pro quo* for filing a proof of claim is a partial waiver of its sovereign immunity. This forced partial waiver requires only that a state come into the proceeding on equal terms with others.[7]

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5 A governmental unit is defined to include the "United States; state; [or] [c]ommonwealth" or any "department, agency or instrumentality" thereof." 11 U.S.C. § 101(26) (1988). No party questions that Appellants fall within this definition.

6 The language in Section 106(a) refers to a "claim" which is effected in the context of a bankruptcy proceeding by the filing of a "proof of claim."

7 This case is not unique in that the filing of a proof of claim may effect the waiver of an otherwise secure constitutional right. Most recently in *Grand-*

Once immunity has been waived, the state has subjected itself to any liability it has to the estate relating to the claim and transaction at issue. Section 106(a) "conditions the state's receiv[ing] a distribution from the estate upon waiver of immunity against *any* compulsory counterclaims asserted against it without limit in a bankruptcy proceeding." *In re Willington Convalescent Home, Inc.*, 850 F.2d 50, 54 (2d Cir.1988). *See also* H. R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977). As the Second Circuit concluded, "[A]ccordingly, § 106(a) provides for affirmative recovery, including money judgments." *Id. See also In re Prudential Lines, Inc. v. United States Maritime Administration*, 79 B.R. 167, 180 (Bankr. S.D.N.Y. 1987); *In re Inslaw, Inc.*, 76 B.R. 224, 234 (Bankr. D.D.C. 1987).

Here, there is no disagreement that pursuant to section 106(a) Appellants have waived their immunity defenses as to certain claims involving approximately $3 million of sales and withholding taxes by filing a proof of claim on January 29, 1989. The dispute is over the scope of the immunity waived by Appellants upon the later filing of Claim 300, which charges in part that Appellees' estate owes approximately $2.1 million in additional gains taxes relating to the original Stanhope transaction over and above the approximately $2.6 million already paid. This Court concludes, based on the language in section 106(a), which states in pertinent part that "any claim against such governmental unit . . . that arose out of the same transaction or occurrence out of which such government unit's claim arose," that Appellants have waived their immunity defense as to counterclaims involving all gains tax liability related to the Stanhope transaction. All gains tax liability includes both the original 2.6 million Gains Tax and the $2.1 million of additional tax liability outlined in Claim 300 since they are both part of the same claim, arising from the same transaction.

The Appellants advance a three-tiered argument in support of their appeal on this issue. First, they argue that there was no

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financiera, S.A. v. Nordberg, ___ U.S. ___, 109 S. Ct. 2782 (1989), the Supreme Court held that filing a proof of claim with a bankruptcy court alters a party's Seventh Amendment right to a jury trial. *See also Katchen v. Landy*, 382 U.S. 323 (1966).

intentional waiver of the State's immunity rights and that filing a proof of claim is not *per se* a waiver. Appellants suggest that since they "vigorously asserted" the immunity defense while filing the proof of claim, *i.e.* Claim 300, and that such filing was a "routine administrative act performed by a mid-level official," that waiver could not have been intended and is inequitable. Appellant's memorandum of law at 35. In essence Appellants suggest that a filing of a proof of claim by an official is not "the same as a declaration of waiver by an attorney in court" because, in the latter case, "the court may remind the attorney of his client's previous assertions of the defense and inquire [about] . . . the actual intent of the client." *Id.*[8]

The statutory language does not support Appellants' contention. Under section 106(a), a court is not required to evaluate a governmental unit's intention in asserting a claim against the debtor's estate. Any requirement as to intent is satisfied where the State acts in a way which conforms to the terms of the statute. A court is asked simply to determine whether a claim has been made which arises from the same transaction. *See In re Lile*, 96 Bankr. 81, 84 (Bankr. S.D. Tex.1989). The reasoning in *Hoffman*, 109 S. Ct. at 2822, and *Gardner*, 329 U.S. at 574, likewise, suggest that by filing a proof of claim, a state has offered concrete evidence of its intent to waive any immunity defenses.

Second, Appellants suggest that even if the Court concludes, as it has, that the filing of a proof of claim waives immunity,

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8 In further resisting the conclusion that the State waived any immunity defenses, Appellants suggest that an intentional waiver of sovereign immunity in this instance would have been meaningless since the Gains Tax "had already been paid." Appellants memorandum of law at 8. Yet, this assertion fails to account for the provisional nature of the tax paid. The amount of the Gains Tax was determined by a Tentative Assessment and Return, issued by the Tax Department. *Id.* at 5. Under New York law, the State has three years from the date of transfer to make an additional Gains Tax assessment on a sale. New York Tax Law § 1444.3(a) (Law. Co-op. 1990). Further, Appellants argument does not account for the significant additional revenue the State stood to gain by filing a proof of claim. Claim 300 asserts additional tax liabilities of $2.1 million of Gains Tax based on the same transaction—the sale of the Stanhope.

the statutory language in section 106(a) subjects the State to a very limited waiver of immunity, allowing counterclaims only as to the specific proof of claim filed, which in this case is the approximately $2.1 million of taxes at issue in Claim 300. The problem with this interpretation is that it ignores the language in the statute referring to "any claim . . . that arose out of the same transaction." The additional $2.1 million of tax liability arises out of the same Stanhope transaction and is based on a provision of the Gains Tax Law which allows the Appellants to re-evaluate whether the first assessment imposed in the pre-sale audit is sufficient. In order to assert a right against the debtor's estate for additional taxes, involving the same transaction, Appellants must file a proof of claim to effectuate their request for funds under the control of the Bankruptcy Court. As discussed above, this, in essence, requires waiving any immunity defenses as to the claim at issue.

A final argument advanced by Appellants is that a waiver of immunity cannot be applied retroactively to affect the Gains Tax paid prior to the sale of the Stanhope. While the Second Circuit has not directly addressed this question, the issue is not one of first impression. In *WJM, Inc. v. Massachusetts Department of Public Welfare*, 840 F.2d 996, 1002-04 (1st Cir.1988), the First Circuit held that a waiver by a state entity was binding, although the filing of a proof of claim occurred some months after the adversary proceedings were concluded, but before the opinion was issued. Factually, *WJM* is on all fours with this action, if not a more difficult case. As the First Circuit recognized, federal medicaid reimbursement law *required* the State of Massachusetts to file a proof of claim to recover any potential overpayment it made. In concluding, nonetheless, that the State had waived any immunity defenses, the court wrote, "we think the waiver should be viewed as having retroactively validated the bankruptcy court's earlier, as well as its subsequent, actions" on the claims. *Id* at 1004.

This Court concludes that the reasoning in *WJM* is sound and should be followed in this instance. Since the Appellants derived certain benefits from the Bankruptcy Court by potentially retrieving assets that might otherwise have been lost, it

would be inequitable to permit the debtors' claims as to the transaction at issue to be frustrated by allowing the State to establish immunity as to a portion of the claim merely by waiting a certain period to file a proof of claim. If this Court were to accept Appellants' arguments, the State would gain all the advantages of the Bankruptcy Court without being subject to its jurisdiction. For this reason, the Court concludes that the significant fact for immunity purposes is that the State filed a proof of claim—not the date that such a filing occurred. As such, Appellants voluntarily waived any immunity defenses on claims involving the Gains Tax liability.

B. *Transfer or Income Tax?*

Turning to the merits we note as a preliminary matter that this Court has jurisdiction over this matter pursuant to 28 U.S.C. § 158(a) (1988), since this is an appeal from a final judgment of the Bankruptcy Court rendered in an adversary proceeding. The controversy in this case is whether the Gains Tax paid by Appellees to Appellants, under the New York Tax Law[9], in order to transfer their interest in the Stanhope pursuant to a Bankruptcy Court Plan, is correctly characterized as an income tax or a transfer tax. The Bankruptcy Code exempts debtors, such as Appellees, pursuant to a plan of reorganization, from all transfer, stamp and similar taxes upon the sale of real property. No such exemption applies for income taxes. Based on the statutory language in the Bankruptcy Code, federal case law, and state and federal tax opinion letters, this Court concludes that the Gains Tax imposed on the income received from the sale of the Stanhope was similar to a transfer or stamp tax. Appellees were therefore entitled to an exemption under the Bankruptcy Code from the New York Gains Tax.

Section 1146(c) of the Bankruptcy Code states, in pertinent part:

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9 The New York Tax Law states, "A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain."

> The issuance, transfer, or exchange, of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp or similar tax.

11 U.S.C. § 1146(c) (1988). Congress's apparent purpose in enacting section 1146 was to facilitate reorganizations through the granting of tax relief. According to the legislative history, congressional intent was to give greater relief to debtors than that which was available under section 267 of the Bankruptcy Act. The Report of the House Judiciary Committee stated, "Section 1146(c) of title 11 broadens the exemption to any stamp or similar tax on a security or transfer instrument dealt with under the consolidated chapter 11. No opposition has been voiced with respect to this section." H.R. Rep. No. 595, 95th Cong., 1st Sess. 281 (1977), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5963, 6238.

The controversy in this action concerns that portion of section 1146(c) which limits exemptions under the Bankruptcy Code to a "stamp or similar tax." At issue is the definition and parameter of a "stamp or similar tax."[10] While the Second Circuit has considered the statutory meaning of certain portions of section 1146(c) of the Bankruptcy Code, including the legal effect of a "transfer under a plan," it has never reached the question of whether the Gains Tax is a "stamp or similar tax." *See City of New York v. Jacoby-Bender, Inc.*, 758 F.2d 840, 841-42 (2d Cir. 1985). The only relevant appellate guidance to this case is the Second Circuit Court's rejection in *Jacoby-Bender* of a constricted view of section 1146(c) of the Bankruptcy Code. Focusing upon the practical workings of the exemption, the Court adopted a mode of analysis which suggests a broad reading of this portion of the Bankruptcy Code. *Id.*

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10 There is no disagreement in the application of other aspects of section 1146(c). Certainly Appellees have "transferred" a parcel of real property, the Stanhope, and that the sale of the property was in connection with a confirmed bankruptcy "plan."

The only prior case which specifically addresses whether the Gains Tax constitutes a "stamp or similar tax" is the bankruptcy court decision in *In re Jacoby-Bender, Inc.*, 40 Bankr. 10 (Bankr. E.D.N.Y. 1984), *aff'd mem.*, No. 84-1564 (E.D.N.Y. Sept. 18, 1984), *aff'd*, 758 F.2d 840 (2d Cir.1985). There the Bankruptcy Court held that the Gains Tax was akin to an income tax and not exempt under section 1146(c) because it was levied upon only the gain realized by the debtor and not upon the instrument of transfer.[11] In the instant case, the Bankruptcy Court held that the tax was a transfer tax, which is similar to a stamp tax, since it is imposed on a transaction by transaction basis without regard to whether taxpayers realized a gain or suffered a loss from all of its transactions during the relevant period.

While there is little guidance available in determining whether the Gains Tax at issue is a "stamp or similar tax" within the meaning of the Bankruptcy Code, the Court is not without some guideposts. In other contexts, federal courts have identified the characteristics relevant to determining whether a particular levy by the state is a stamp tax. There are three common elements present in all stamp taxes. First, the tax is imposed only upon a transfer or sale of the item at issue. Second, the amount of tax due is determined by the consideration recited in the deed of the transfer. Finally, the taxes must have been paid as a prerequisite to recording. *See Lee v. Bickell*, 292 U.S. 415, 417 (1934) (stamp tax placed on original issue and transfer or sale of stocks and bonds); *Texaco, Inc. v. United States*, 624 F.2d 20, 21 (5th Cir. 1980) (federal stamp tax on deeds by which realty is transferred).[12]

Applying these general criteria, the Second Circuit analysis of section 1146(c) outlined in *Jacoby*, and congressional intent

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11 This portion of the Bankruptcy Court's decision was not addressed by the Second Circuit in *Jacoby-Bender* since New York State had stipulated to return the Gains Tax payment, thereby mooting appellate review. 768 F.2d at 840-43.

12 Stamp taxes may have characteristics such as actual stamps on the written instrument to show that a tax has been paid. The absence of an actual stamp, however, is not necessarily determinative that the tax paid is not a stamp tax or similar type tax. *See Jacoby-Bender, Inc.*, 40 Bankr. at 10.

to give greater tax relief to debtors, we conclude that the essential stamp tax characteristics are present in the Gains Tax. First, the tax is imposed on a transaction by transaction basis, payable on transfer, without regard for other transfers made over a given time. Second, the consideration paid to the transferor and recited in the instrument, *i.e.*, the deed, plays an essential role in assessing the amount of Gains Tax due. In fact, the primary considerations are the acquisition cost and the sale cost.[13] Finally, the Gains Tax must be paid at the time of transfer, as state law prohibits recording of the conveyance until this act is done. *See* N.Y. Tax Law § 1447(f) (McKinney 1987). Failure to record makes null and void the conveyance of real property to a subsequent purchaser who acquires the property in good faith and for valuable consideration. *See* N.Y. Real Property Law § 291 (McKinney 1989). It was for precisely this reason that Appellees paid the Gain Tax assessed, rather than awaiting an outcome of the matter in the Bankruptcy Court.

There are other factors that indicate that the New York Tax Law is a transfer or stamp tax based on the transfer of real property rather than on the income generated thereby. First, the original purchase price is not adjusted to reflect depreciation cost deductions allowed in the operation of commercial real estate. Without this adjustment for depreciation, the Gains Tax is not based on a true measure of accrued wealth, as would be the case for calculating gain for income tax purposes. Second, the Gains Tax is not assessed against all profitable transactions. Only those transfers in which the consideration exceeds $1,000,000 are subject to this tax. There is no Gains Tax imposed until this amount is exceeded, at which point the entire gain is taxed at ten percent, not merely that portion of the gain exceeding $1,000,000. Third, unlike income tax liability, the transferee is secondarily liable for the amount owed if the transferor does not pay the Gains Tax. In toto, the result

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13 Certain statutorily permitted adjustments (including certain capital improvements and fees paid to brokers, surveyors, engineers and attorneys) are added to the transferor's original purchase price and then subtracted from the consideration received for the transfer. *See generally* N.Y. Tax Law § 1440(5) (McKinney 1987); 20 N.Y. Comp. Codes R. & Regs. § 590.14-17 (1988).

is the taxation of a certain class of transfers and not the taxation of a certain class of income.

This interpretation is also consistent with both federal and state revenue rulings. The State of New York has made certain revenue rulings with respect to the Gains Tax concluding that it is a transfer tax rather than an income tax. On September 21, 1983, the Tax Department found:

> The State gains tax is a transfer tax rather than a property or income tax since the triggering mechanism of the tax is the transfer of real property. Whereas the gains tax is a tax upon the transfer of real property, a property tax is a levy on the property itself. Income taxes are generally applied to net gain. Under the gains tax, the loss from one transfer of real property does not effect the applicability of the gains tax as to another transfer of real property in the same tax year. For these reasons, it is our opinion the State gains tax should be classified as a State transfer tax and should be treated as such for purposes of deductibility.

See Appendix A. A few months later, in another letter describing the Gains Tax and reiterating their prior position, the State wrote, "the tax is classified by New York as a transfer tax . . . because it is triggered by the transfer of the property, not by other incidents of ownership." *See Appendix B*.

In both of these rulings, the State was influenced by Internal Revenue Service ("IRS") ruling 80-121 which held that a gains tax in Vermont, similar to the Gains Tax, was a transfer and not an income tax for federal tax purposes. The IRS took this position primarily because the Vermont State tax was not structured to account only for net gain. Under the Vermont tax, as under the Gains Tax, a taxpayer could make two transfers on the same day, one earning $1,000,000 and the other losing $1,000,000 so that at the end of the day there has been no net increase in wealth. Nonetheless, the taxpayer would be liable for the gains tax on the profitable transaction and could not offset losses. Furthermore, the Vermont gains tax did not allow for depreciation or other types of costs usually associated with arriving

at the economic net gain. In order for IRS to characterize a tax as an income tax under section 164(a)(3) of the Internal Revenue Code, a taxpayer must be allowed to reduce taxable gains by any losses experienced during the same tax year and to deduct depreciation costs.

Appellants suggest that these tax opinions are merely advisory and are not binding on New York with respect to this debtor. The only estoppel effect these opinions have, according to Appellants, is with respect to the parties who made the requests for the advice. *See* 20 N.Y. Comp. Codes R. & Regs. § 901.4 (1988). Moreover, the Appellants argue that these rulings do not suggest that the Gains Tax is a stamp tax. Rather, Appellants urge that a stamp tax is an excise tax which is imposed on such events as the drawing of a will, deed or mortgage recordings and taxes on such goods as cigarettes and liquor. According to the Appellants the transfer of the Stanhope is not akin to the types of events and goods upon which a stamp is affixed.

Appellants' arguments are unavailing. First, while the state tax rulings are not binding on this court, they are persuasive evidence that the Gains Tax is not an income tax. Moreover, Appellants' suggestion that the stamp tax should be narrowly understood as applying only to a few events is equally unpersuasive. This argument fails to account for the statutory language of section 1146(c) which does not limit the tax exclusion only to a stamp tax. Section 1146(c) exempts "a stamp or *similar tax*" (emphasis added). Since the Gains Tax has many of the characteristics of a stamp tax and few of the qualities of an income tax, this Court concludes that Appellees were entitled to an exemption under section 1146(c) of the Bankruptcy Code since the Gains Tax is a "stamp or similar tax."

The Opinion and Order of the Bankruptcy Court are affirmed.

SO ORDERED.

Dated: May 16, 1991
New York, New York

/s/ [ILLEGIBLE]
U.S.D.J.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

90 Civ. 5744 (LBS)

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiffs-Appellees,

—against—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, JAMES W. WETZLER as Commissioner of Taxation and Finance, and EDWARD V. REGAN as Comptroller of the State of New York,

Defendants-Appellants.

ORDER AMENDING OPINION

SAND, J.

The Opinion rendered in this matter dated May 16, 1991 is hereby amended to include Appendix A and Appendix B referred to on page 18 of the Opinion.

SO ORDERED.

Dated: May 17, 1991
New York, New York

/s/ [ILLEGIBLE]
U.S.D.J.

APPENDIX A

STATE OF NEW YORK
Department of
Taxation and Finance
Albany, New York 12227
Law Bureau
State Campus,
Albany, New York 12227
September 21, 1983

Dear :

This letter is in reply to your inquiries of June 9 and June 27, 1983 concerning Article 31-B of the Tax Law, the New York Real Property Transfer Gains Tax. You had questions as to the treatment of the tax for State corporate franchise and personal income tax purposes, and as to how the "acquisition of controlling interest" provisions of the tax are to be applied.

In order to determine the deductibility of the gains tax for corporate franchise and personal income tax purposes, the tax must first be classified. The New York State Real Property Transfer Gains Tax is a levy on gains derived from the transfer by any method of an interest in real property located in New York where the consideration is one million dollars or more.

The State gains tax is a transfer tax rather than a property or income tax since the triggering mechanism of the tax is the transfer of real property. Whereas the gains tax is a tax upon the transfer of real property, a property tax is a levy on the property itself. Income taxes are generally applied to net gain. Under the gains tax, the loss from one transfer of real property does not effect the applicability of the gains tax to another transfer of real property in the same tax year. For these reasons, it is our opinion that the State gains tax should be classified as a State transfer tax and should be treated as such for purposes of deductibility.

It should be noted, however, that though the Department's views are expressed herein, the Internal Revenue Service will ultimately determine the deductibility of the gains tax for Fed-

eral tax purposes, and that State tax policy is usually formulated in accordance with the Federal treatment of the tax. It is our opinion, in light of Revenue Ruling 80-121, that the Internal Revenue Service will classify the gains tax as being a transfer tax. In that ruling, Vermont's land gains tax, as imposed by sections 10001 through 10010, Title 32, of the Vermont Statutes Annotated, was deemed to be a transfer tax. The Vermont land gains tax is conceptually similar to New York's gains tax in that the Vermont statute levies a tax on gain from the sale or exchange of land. Under their statute, a sale or exchange of land is any transfer of title to land for a consideration, and taxable gain is the amount realized from a sale or exchange of land, less the transferor's basis in the land.

Section 164(a) of the Internal Revenue Code describes various types of taxes that are allowed as a deduction for the taxable year within which paid or accrued. Specifically allowed are: (1) State and local real property taxes; (2) State and local personal property taxes; (3) State and local income taxes; and (4) State and local general sales taxes. Section 164(a) of the Code also allows, as a deduction, State and local taxes not specifically described that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

In determining that the Vermont land gains tax is a transfer tax, Revenue Ruling 80-121 first distinguished other forms of taxes as not being applicable. The Ruling provides, in pertinent part, as follows:

> "The Vermont land gains tax is not imposed or triggered by the ownership of real property, but rather, by the exercise of one of the incidents of property ownership, the transfer of real property at a gain. The land gains tax is not measured by the value of the real property, but rather, by the gain derived from the transfer of that property . . . . Thus, the land gains tax is not a real property tax within the meaning of section 164(a)(1) of the Code."

With respect to the Vermont land gains tax qualifying as a State income tax within the meaning of section 164(a)(3) of the

Code, the Revenue Ruling distinguishes the land gains tax from Federal income taxes, stating that the State tax, unlike the Federal income tax, is not structured to fall on net gain. The taxpayer, as a result of the gains tax, cannot reduce taxable gain from sales or exchanges of land during the taxable year by any losses from other sales or exchanges of land during that year. Under Federal income tax law, taxpayers are allowed to reduce gains from sales or exchanges of land by losses from sales or exchanges of land. Noting that a taxpayer could be required to pay the land gains tax even though under Federal income tax laws that same taxpayer may have a net loss from sales or exchanges of land, the ruling concluded that the tax is not an income tax under section 164(a)(3) of the Code.

In light of Revenue Ruling 80-121, it is the Department's opinion that the New York State Real Property Transfer Gains Tax is a transfer tax, and for purposes of Federal deductibility, the tax is deductible for purposes of computing adjusted gross income under section 164(a) of the Internal Revenue Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business, or in connection with an activity described in section 212 of the Internal Revenue Code relating to expenses for the production of income.

For State income tax purposes, section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means his Federal adjusted gross income, with certain modifications. Since the State gains tax will be deductible for purposes of computing Federal adjusted gross income, it will automatically be excluded from the computation of New York adjusted gross income, since there is no provision in the Tax Law adding back such amounts for purposes of such computation. A similar provision is found in Article 9-A of the Tax Law, the corporate franchise tax. Section 208 defines "entire net income" to mean total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department. Since the State gains tax will be deducted from the taxable income the taxpayer is required to report to the United States Treasury Department, the tax will automatically be excluded from the computation of the state

franchise tax since there is no provision adding it back for purposes of computing entire net income.

With regard to your inquiry as to how the acquisition of controlling interest provisions of the tax are to be applied, one must look to what is acquired, not to what is maintained. The tax is imposed on gains from the transfer of any interest in real property, which is defined to include "acquisition of a controlling interest" in any entity with an interest in real property. (Tax Law, § 1440.7) The term "controlling interest" is defined in section 1440.2 of the Tax law to mean:

> "(i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation, and
>
> (ii) in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity."

The key term in these provisions is "acquisition". For purposes of the gains tax, if no partner acquires a controlling interest in the partnership, there is no transfer subject to the tax. In the case of a corporation which has an interest in real property, the acquisition of a controlling interest in the corporation occurs when an individual, group of individuals acting in concert to avoid the tax, or another entity becomes the owner of 50% or more of the voting stock in such corporation. Because the statute looks to the acquisition of the controlling interest, it is the act of the transferee which triggers the tax.

For your further information, I am enclosing a copy of Publication 588 containing questions and answers on the gains tax or real property transfers.

Very truly yours,

JOHN P. DUGAN
Deputy Commissioner and Counsel

TWS/cjm
Enclosure

APPENDIX B

STATE OF NEW YORK
Department of
Taxation and Finance
Albany, New York 12227
Law Bureau
State Campus,
Albany, New York 12227
November 14, 1983

Dear :

This letter is in response to your inquiry of September 23, 1983 regarding Article 31-B of the Tax Law, The New York Real Property Transfer Gains Tax. You asked whether the payment of tax pursuant thereto would avail the taxpayer of a credit or deduction for partnership or individual income tax purposes. It is our opinion that, if anything, a deduction would be allowed.

The treatment of taxes for such purposes largely depends upon the classification of the tax. Comparably classified taxes generally receive similar deduction treatment. The New York State Real Property Transfer Gains Tax is a levy on gains derived from the transfer by any method of an interest in real property located in New York where the consideration is one million dollars or more.

The tax is classified by New York as a transfer tax rather than a property tax because it is triggered by the transfer of the property, not by other incidents of ownership, and not levied on the land itself.

It should be noted, however, that though the Department's views are expressed herein, the Internal Revenue Service will ultimately determine the deductibility of the gains tax for Federal tax purposes, and that State tax policy is usually formulated in accordance with the Federal treatment of the tax. It is our opinion, in light of Revenue Ruling 80-121, that the Internal Revenue Service will classify the gains tax as being a transfer tax. In that ruling, Vermont's land gains tax, as imposed by

sections 10001 through 10010, Title 32, of the Vermont Statutes Annotated, was deemed to be a transfer tax. The Vermont land gains tax is conceptually similar to New York's gains tax in that the Vermont statute levies a tax on gain from the sale or exchange of land. Under their statute, a sale or exchange of land is any transfer of title to land for a consideration, and taxable gain is the amount realized from a sale or exchange of land, less the transferor's basis in the land.

Section 164(a) of the Internal Revenue Code describes various types of taxes that are allowed as a deduction for the taxable year within which paid or accrued. Specifically allowed are: (1) State and local real property taxes; (2) State and local personal property taxes; (3) State and local income taxes; and (4) State and local general sales taxes. Section 164(a) of the Code also allows, as a deduction, State and local taxes not specifically described that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

In determining that the Vermont land gains tax is a transfer tax, Revenue Ruling 80-121 first distinguished other forms of taxes as not being applicable. The Ruling provides, in pertinent part, as follows:

> "The Vermont land gains tax is not imposed or triggered by the ownership of real property, but rather, by the exercise of one of the incidents of property ownership, the transfer of real property at a gain. The land gains tax is not measured by the value of the real property, but rather, by the gain derived from the transfer of that property . . . . Thus, the land gains tax is not a real property tax within the meaning of section 164(a)(1) of the Code."

With respect to the Vermont land gains tax qualifying as a State income tax within the meaning of section 164(a)(3) of the Code, the Revenue Ruling distinguishes that land gains tax from Federal income taxes, stating that the State tax, unlike the Federal income tax, is not structured to fall on net gain. The taxpayer, as a result of the gains tax, cannot reduce taxable gain from sales or exchanges of land during the taxable year by

any losses from other sales or exchanges of land during that year. Under Federal income tax law, taxpayers are allowed to reduce gains from sales or exchanges of land by losses from sales or exchanges of land. Noting that a taxpayer could be required to pay the land gains tax even though under Federal income tax laws that same taxpayer may have a net loss from sales or exchanges of land, the ruling concluded that the tax is not an income tax under section 164(a)(3) of the Code.

In light of Revenue Ruling 80-121, it is the Department's opinion that the New York State Real Property Transfer Gains Tax is a transfer tax, and for purposes of Federal deductibility, the tax is deductible for purposes of computing adjusted gross income under section 164(a) of the Internal Revenue Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business, or in connection with an activity described in section 212 of the Internal Revenue Code relating to expenses for the production of income.

For State income tax purposes, section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means his Federal adjusted gross income, with certain modifications. Since the State gains tax will be deductible for purposes of computing Federal adjusted gross income, it will automatically be excluded from the computation of New York adjusted gross income, since there is no provision in the Tax Law adding back such amounts for purposes of such computation. A similar provision is found in Article 9-A of the Tax Law, the corporate franchise tax. Section 208 defines "entire net income" to mean total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department. Since the State gains tax will be deducted from the taxable income the taxpayer is required to report to the United States Treasury Department, the tax will automatically be excluded from the computation of the state franchise tax since there is no provision adding it back for purposes of computing entire net income.

For your further information, I am enclosing a copy of Publication 588 containing questions and answers on the gains tax or real property transfers.

Very truly yours,

JOHN P. DUGAN
Deputy Commissioner and Counsel

LMP:pbc
Enclosure

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Case No. 88 B 10237 (TLB)
Chapter 11
Adv. Pro. No. 89-5449A

August 2, 1990

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiff,

—against—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, JAMES W. WETZLER AS COMMISSIONER OF TAXATION AND FINANCE, AND EDWARD V. REGAN AS COMPTROLLER OF THE STATE OF NEW YORK,

Defendants.

JUDGMENT AND ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT
(A&F #303)

Upon the amended complaint dated March 6, 1989 by 995 Fifth Avenue Associates, L.P. ("Plaintiff"); and upon the order of the Court dated November 29, 1988 authorizing, *inter alia*, the Plaintiff to sell its interest in a hotel and related restaurant and catering facilities together with the assignment of a lease for non-residential real property (the "Stanhope Hotel"); and

upon the amended proof of claim of New York State dated October 23, 1989; and upon Plaintiff's motion ("Motion") for summary judgment dated May 1, 1989, seeking a judgment by the Court that: (a) the sale ("Sale") by the Plaintiff of its interest in the Stanhope Hotel pursuant to a Chapter 11 plan of reorganization under Title 11 of the United States Bankruptcy Code ("Bankruptcy Code") was exempt under Section 1146(c) of the Bankruptcy Code from the imposition of the tax imposed on the gains derived from the transfer of real property within the State of New York pursuant to N.Y. Tax Law § 1441 ("Gains Tax"); and (b) the payment made under protest by the Plaintiff in the amount of $2,608,603.80 ("Gains Tax Payment") in satisfaction of its alleged Gains Tax liability be refunded to the Plaintiff; and upon the papers filed by the Plaintiff in support of the Motion; and upon the papers filed by the Defendants in opposition to the Motion; and a hearing having been held before me on May 23, 1989; and the Plaintiff having appeared by Joshua J. Angel, Esq. and Leonard H. Gerson, Esq. of Angel & Frankel, P.C.; and the Defendants having appeared by David S. Cook, Esq., Assistant Attorney General of the State of New York; and upon the record of said hearing held before me; and upon the written decision of this Court, dated July 13, 1990; it is

Now, upon motion of Angel & Frankel, P.C., attorneys for the Plaintiff,

ORDERED, ADJUDGED AND DECREED that:

1. The Sale was and is exempt from payment of the Gains Tax pursuant to Section 1146(c) of the Bankruptcy Code.

2. New York State has waived its sovereign immunity with respect to the Gains Tax for which it has filed a proof of claim in this case.

3. Defendants be, and they hereby are authorized and directed to refund to the Plaintiff, within eleven (11) days after the date of entry of this order, the Gains Tax Payment plus interest at the legal rate from the date on which the Gains Tax

Payment was made through and including the date on which the refund directed by this order is delivered to the Plaintiff.

4. Defendants' cross-motion for summary judgment for failure to state a claim be, and the same hereby is denied.

Dated: New York, New York
August 1, 1990

/s/ TINA L. BROZMAN
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Case No. 88 B 10237(TLB)
Chapter 11
Adv. Pro. No. 89-5449A

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

995 FIFTH AVENUE ASSOCIATES, L.P.

Plaintiff,

—against—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, JAMES W. WETZLER as Commissioner of Taxation and Finance, and EDWARD V. REGAN as Comptroller of the State of New York,

Defendants.

DECISION GRANTING MOTION FOR SUMMARY JUDGMENT

ANGEL & FRANKEL, P.C. by Joshua J. Angel, Leonard H. Gerson, Ira R. Abel, New York City, for debtor.

ROBERT ABRAMS, Atty. Gen. of the State of New York by David Cook, Marcie Mintz, New York City, for defendants.

TINA L. BROZMAN, *United States Bankruptcy Judge.*

At issue in this adversary proceeding is whether section 1146(c) of the Bankruptcy Code, 11 U.S.C.A. § 1146(c) (West Supp. 1990) (Section 1146(c)) exempts a debtor in possession from payment of the tax imposed on the gains derived from the transfer of real property within the State of New York pursuant to N.Y. Tax Law § 1441 (McKinney 1987) (the Gains Tax). 995 Fifth Avenue Associates, L.P. (the Debtor), the debtor in this chapter 11 case, moves for summary judgment arguing that Section 1146(c) does apply and that the $2,608,603.80 Gains Tax payment it made under protest should be returned. The New York State Department of Taxation and Finance (the Tax Department), James W. Wetzler as Commissioner of Taxation and Finance, and Edward V. Regan as Comptroller of the State of New York (collectively, New York) have cross-moved for summary judgment to dismiss for failure to state a claim, arguing that the Section 1146(c) exemption does not apply and that the Eleventh Amendment and the doctrine of sovereign immunity are complete defenses to the adversary proceeding. For the reasons set forth below, I conclude that Section 1146(c) does exempt the Debtor from liability for the Gains Tax and that neither the Eleventh Amendment nor the doctrine of sovereign immunity precludes entry of judgment against New York because it filed a proof of claim relating to the Gains Tax after it interposed its claim of immunity.

I. Background

The salient facts are largely undisputed. The Debtor filed its Chapter 11 petition on February 4, 1988. Its business was the operation of a hotel and related restaurant and catering facilities known as the Stanhope Hotel (the Stanhope), a business which the Debtor continued to operate as debtor in possession. Over the course of the bankruptcy case, the Debtor filed an original and three subsequent amended plans of reorganization (collectively, the Plan), all of which contemplated the sale of

the Debtor's interest in the Stanhope. On July 20, 1989, the Plan was confirmed.

Prior to confirmation and by order dated November 29, 1988 (the Sale Order), I authorized the Debtor to sell and/or assume and assign its interest in the Stanhope for $76,000,000. The Sale Order declared that the sale was being made under a plan of reorganization and, pursuant to Section 1146(c), would be exempt from any federal, state, or local transfer taxes. The closing of the sale was scheduled for January 13, 1989. On January 12, pursuant to the pre-transfer audit procedures provided by N.Y. Tax Law § 1447 (McKinney 1987), New York issued a Tentative Assessment and Return imposing a Gains Tax of $2,608,603.80 on the proposed sale and transfer. Citing the relevant provisions of the Sale Order and Section 1146(c), the Debtor requested but was denied an exemption from the Gains Tax. Because state law prohibits recordation in the local land records without payment of any tax due under the Tentative Assessment and Return, the Debtor paid the Gains Tax under protest to allow the deed to be recorded and the sale to close the following day. N.Y. Tax § 1447(f) (McKinney 1987). Since the filing of the petition, New York has filed claims against the Debtor's estate based on both pre and post-petition tax obligations, with the most recent amended claim including a liability for the Gains Tax.[1]

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1 New York filed an amended claim dated October 23, 1989 which it designated as "3rd Amended Administrative Expense" (claim number 300 on the Clerk of the Court's claims docket). The cover sheet attached to claim number 300 indicates that the amendment is based in part "on the addition of Gains Tax Liability" with the text of the claim referencing the statutory provision imposing the tax. Claim number 300 was filed after I heard oral argument on the summary judgment motions and after the parties submitted post-trial memoranda in support of their respective positions. In light of New York's voluntary submission to my jurisdiction, most of its challenges to my ability to grant the relief sought by the Debtor have evaporated.

II. The 1146(c) Exemption

Section 1146(c) provides:

> The issuance, transfer, or exchange of a security or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

For the exemption from tax liability to apply, a three pronged test must be fulfilled: 1) the tax must be a stamp or similar tax; 2) imposed upon the making or delivery of an instrument transferring an interest in real property; and 3) in connection with a confirmed bankruptcy plan. *In re The Baldwin League of Independent Schools*, case No. 88 B 10401(CB) (June 21, 1988) (oral op.), *aff'd*, 110 Bankr. 125 (S.D.N.Y. 1990). The major challenge in this case is the satisfaction of the first prong, that is, whether the Gains Tax qualifies as a stamp or similar tax. New York relies almost exclusively on the bankruptcy court's decision in *In re Jacoby-Bender, Inc.*, 40 Bankr. 10 (Bankr. E.D.N.Y. 1984), *aff'd mem.*, No. 84-1564 (E.D.N.Y. Sept. 18, 1984), *aff'd*, 758 F.2d 840 (2d Cir.1985), which held that the Gains Tax was not exempt under Section 1146(c). So much of the bankruptcy court's decision as dealt with the Gains Tax was never appealed.

In *Jacoby*, the debtor sought an order exempting it from payment of the New York City Real Estate Transfer Tax, the New York State Real Estate Transfer Tax (collectively the Transfer Taxes) and the New York State Capital Gains Tax, the same Gains Tax presently in issue. The *Jacoby* court inquired into the meaning of the phrase "stamp or similar tax" but found no legislative history or court decisions directly construing Section 1146(c) or its precursors. It reasoned that two essential characteristics of stamp taxes are that the amount of the tax is usually determined by the consideration recited in the deed of transfer and that the taxes must be paid as a prerequisite to recording. Other characteristics of lesser importance to the Court's analysis included the use of stamps as visible evidence that the tax had been paid (deemed not "crucial" to the purpose

served by the statutory exemption) and the "technical" feature that stamp taxes are charged on written instruments recognized in law as evidence of the enforcement of legal rights. *Jacoby*, 40 Bankr. at 13; *see also In re Amsterdam Ave. Dev. Assoc.*, 103 Bankr. 454, 456-57 (Bankr. S.D.N.Y. 1989) (citing *Jacoby*). Further, the *Jacoby* court noted that stamp taxes are similar to excise taxes, which are generally imposed upon the sale or use of certain articles and on certain transactions.

Carefully examining the characteristics of the Transfer Taxes, the court held them to fall within the purview of Section 1146(c). It noted that the amount of the Transfer Taxes is determined by the consideration or value of the property conveyed; that payment of the taxes is a precondition to recording; that recordation of the deed is "clear and convenient evidence" of payment of the Transfer Taxes so that affixing stamps to the instrument of transfer is not necessary; and that the Transfer Taxes are taxes upon deeds recognized in law as important evidence of legal rights.

When considering the possible exemption from the Gains Tax, the *Jacoby* court did not address any of the characteristics it so meticulously reviewed with regard to the Transfer Taxes. Rather, the court found that the only similarity between the Gains Tax and taxes exempt under Section 1146(c) is that both are imposed at the time of transfer. Without further ado, the court held that the Gains Tax was an income tax rather than an excise tax, because it was levied only upon the gain realized by the debtor and not upon the instrument of transfer. The court stated that unlike the Gains Tax, all of the stamp taxes it had previously discussed were imposed regardless of whether the transferor gained or lost money on the transaction. With good reason, New York relies on *Jacoby*, emphasizing that the *Jacoby* holding has been codified in the New York State tax regulations. *See* N.Y. Comp. Codes R. & Regs. tit. 20, § 590.65 (1988).

Although the *Jacoby* debtor appealed the unfavorable determination regarding the Gains Tax, New York State subsequently stipulated to return the Gains Tax payment,[2] thereby

2 The parties here dispute the circumstances leading to the stipulation. That dispute is wholly irrelevant.

mooting appellate review. Accordingly, the decision is not binding precedent as to the Gains Tax. Of lesser precedential value is the incorporation of the *Jacoby* result in the tax regulations of the State of New York; the reach of Section 1146(c) is a federal question to be resolved by defining the scope of federal law. *See Amsterdam*, 103 Bankr. at 458 (citing *United States v. L.N. White & Co.*, 359 F.2d 703, 714 n.16 (2d Cir. 1966)). Moreover, where a state tax has an impact upon a federal right, federal courts are not only free to, but must, look beyond the label affixed by the state to determine the nature of the tax and its effect on the federal right. *Amsterdam*, 103 Bankr. at 458 (citing *Carpenter v. Shaw*, 280 U.S. 363, 367-68, (1930)). It is therefore entirely appropriate to analyze the Gains Tax in light of *Baldwin League's* three pronged test for an exemption under Section 1146(c).

The amount of the Gains Tax is determined by adding statutorily permitted adjustments (including certain capital improvements and fees paid to brokers, surveyors, engineers and attorneys) to the transferor's original purchase price and then subtracting that amount from the consideration received for the transfer. *See generally* N.Y. Tax Law § 1440(5) (McKinney 1987); 20 N.Y. Comp. Codes R. & Regs., §§ 590.14-17 (1988). When the consideration paid for the transfer exceeds the adjusted original purchase price, a gain is realized upon which a ten percent tax is levied. Thus, the consideration paid to the transferor and recited in the instrument of transfer plays an essential role in assessing the Gains Tax due. For all intents and purposes, the Gains Tax must be paid at the time of transfer, as state law prohibits the recording of the conveyance until this act is done. *See* N.Y. Tax Law § 1447(f) (McKinney 1987). Recording the instrument of transfer provides evidence that the Gains Tax has been paid; without recordation, valuable legal rights are forfeited. *See* N.Y. Real Property Law § 291 (McKinney 1989) (any conveyance of real property not recorded is void against a subsequent purchaser who acquires property in good faith and for valuable consideration). Thus, the Gains Tax, like the Transfer Taxes discussed in *Jacoby*, seemingly shares both the essential and technical characteristics of a stamp or similar tax.

New York urges that *Jacoby* correctly classified the Gains Tax as an income tax rather than a transfer tax subject to exemption under Section 1146(c). The word "income" when used in relation to statutory provisions regarding income taxes must be given its plain and ordinary meaning. 71 Am.Jur.2d, *State and Local Taxation* § 483 at 784 (2d ed. 1973).

> In its ordinary and popular meaning, "income" is the amount of actual wealth which comes to a person *during a given period of time. . . . The word in most if not all connections involves time as an essential element in its measurement or definition.* It thus is differentiated from capital or investment, which commonly means the amount of wealth which a person has on a fixed date.

Id. at 784, n.75 (emphasis added) (citation omitted). *See also Black's Law Dictionary* 687 (5th ed. 1979) (income is "[t]he true increase in amount of wealth which comes to a person during a stated period of time"). *Compare Black's Law Dictionary* 1343 (5th ed. 1979) (transfer tax defined as a "[t]ax upon passing of title to property", implying an isolated transaction rather than transactions over a period of time). Indeed, New York's personal income tax provisions are based on a period of time designated as each taxpayer's "taxable year." *See* N.Y. Tax Law § 601 et seq. (McKinney 1987). The Gains Tax, however, is imposed on a transaction by transaction basis, payable on the transfer, without regard for any other transfers made over a given period of time. A taxpayer can make two transfers on the same day, one earning $1,000,000 and the other losing $1,000,000 so that at the end of the day he realizes no increase of wealth as ordinarily contemplated under an income tax scheme. Yet the taxpayer would be liable for the Gains Tax on the isolated, profitable transaction and could not offset his losses on the unprofitable transaction. This is certainly a result more in line with the imposition of a transfer tax than an income tax.

The Tax Department has in other contexts expressly defined the Gains Tax as a transfer tax and distinguished it from an income tax.[3] Specifically, the Tax Department issued two opin-

ion letters addressing taxpayer inquiries into treatment of the Gains tax for income tax purposes. The first of these letters, dated September 21, 1983, unequivocally stated:

> The State gains tax is a transfer tax rather than a property or income tax since the triggering mechanism of the tax is the transfer of real property. Whereas the gains tax is a tax upon the transfer of real property, a property tax is a levy on the property itself. Income taxes are generally applied to net gain. Under the gains tax, the loss from one transfer of real property does not effect the applicability of the gains tax to another transfer of real property in the same tax year. For these reasons, it is our opinion that the State gains tax should be classified as a State transfer tax and should be treated as such for purposes of deductibility.

The letter made reference to a revenue ruling issued by the Internal Revenue Service (the IRS) which held that a similar gains tax imposed by the State of Vermont was a transfer tax and not an income tax. In Revenue Ruling 80-121, the IRS explained that for federal income tax purposes, taxpayers were allowed to reduce gains from the sale of land by any losses incurred on the sale of other land during the taxable year. Rev. Rul. 80-121, 1980-1 C.B. 44. The Vermont tax, however, made no provision to offset gains from profitable real estate transactions against losses on unprofitable transactions and was deemed to be a tax on a particular transfer rather than on income. Noting that New York State tax policy is usually formulated in accordance with federal treatment of a tax, the opinion letter adopted this "net gain" analysis and determined that the Gains Tax was a transfer tax and thus not fully deductible against income. The second opinion letter, dated November 14, 1983, basically reiterated this position.[4] The Tax Department incorporated the conclusions of the two opinion letters, including their review of Rev. Rul. 80-121, into its official publication explaining the Gains Tax. *See* NYS Department of Tax-

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3 Unremarkably, the contradictory constructions of the Gains Tax have the effect of increasing the taxpayer's liability in each instance.

ation and Finance, Questions and Answers–Gains Tax on Real Property Transfers, Publication 588 at 27 (November 1984).

Although such advisory opinions are not binding on New York with respect to this debtor, *see* 20 N.Y. Comp. Codes R. & Regs. § 901.4 (1988), the letters are no less instructive and directly on point. Never has New York argued that the opinion letters were mistaken or that it has subsequently changed its treatment of the tax for allocability of deductions. When asked at oral argument to reconcile the transfer tax analysis found in the opinion letters with its current position that the Gains Tax is an income tax, New York responded simply that the tax could be treated differently for different purposes. While that is undoubtedly true, New York's two positions are diametrically opposed with no articulated basis for the differing treatment of the same tax.

There are other factors which indicate that the Gains Tax is assessed on the transfer of real property rather than on the income generated thereby. First, the "original purchase price" for Gains Tax purposes is not adjusted to reflect depreciation of the real property transferred. Without an adjustment for depreciation, the Gains Tax is not based on a true measure of the transferor's accrued wealth as it would be for calculating the gain for income tax purposes. Second, the fact that the Gains Tax is not assessed against all profitable transactions undercuts the New York's argument that it is an income tax. Only transfers in which the consideration exceeds $1,000,000 are subject to the Gains Tax; once this cap is met the entire gain is taxed, not merely that portion exceeding $1,000,000. Thus, the Gains Tax is levied upon a certain class of transfers and not on a certain class of income. Further support for this theory is found in the fact that profitable transactions of less than $1,000,000 within a taxable period are subject to income tax but not the Gains Tax. Finally, in the event the transferor does not pay the Gains Tax, the transferee becomes personally

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4 The court in *Jacoby* did not discuss and may not have had the benefit of these opinion letters at the time it rendered its decision. Copies of the letters are attached as an appendix to this decision.

liable for the tax. N.Y. Tax Law §§ 1447(3) (McKinney 1987); 20 N.Y. Comp. Codes R. and Regs., § 590.70 (1988). It is abundantly clear that the ultimate goal of the Gains Tax is not to tax the transferor's *income* but rather to tax any *transfers* in which he is involved.

The fact that Gains Tax is imposed only upon profitable transfers does not dictate that it is unlike a stamp or similar tax. The *Jacoby* court found this to be a distinguishing feature, noting that all of the stamp taxes it had reviewed were imposed "regardless of whether the transferor gained or lost money in the transaction involved." 40 Bankr. at 15. However, the Supreme Court has held it constitutional to impose stamp taxes on certain classes of transactions even though others are exempt from tax. *Brodnax v. Missouri*, 219 U.S. 285 (1911); *accord*, 71 Am.Jur.2d, *State and Local Taxation* § 638 at 894 (2d ed. 1973). For all these reasons, I am convinced that the Gains Tax shares the most important characteristics of a stamp or similar tax and that it meets the first prong to qualify for an exemption.

The Gains Tax also satisfies the second precondition for exemption under Section 1146(c). The Gains Tax is due at the time of conveyance and therefore is imposed upon the making or delivery of an instrument of transfer. New York argues that although the timing is identical, the Gains Tax is not imposed on the deed or transfer but rather on the gain realized. *See also Jacoby*, 40 Bankr. at 15. This is similar to the argument rejected in *Federal Land Bank v. Crossland*, 261 U.S. 374 (1923), where the Supreme Court found that a tax on recording a mortgage was equivalent to a tax on the mortgage itself. *See also Amsterdam*, 103 Bankr. at 457-58 (rejecting the argument that a mortgage tax was tax on the "privilege" of recording and not on the mortgage itself). In essence, New York's argument is that the tax is upon the privilege of realizing a gain and not on the transfer itself. However, as with the mortgage taxes discussed above, unless the Gains Tax is paid, the deed or instrument will not be recorded and valuable legal rights will be forfeited. Few purchasers of real property will commit themselves to transactions under these conditions, making recor-

dation an integral component of the conveyance. *Amsterdam*, 103 Bankr. at 458. For our purposes, then, the Gains Tax is analytically a tax on the transfer, and hence a tax on the instrument of transfer, notwithstanding New York's characterization of the prepayment requirement as merely a practical mode of collecting an income tax.

That the final prong of the *Baldwin League* test has been satisfied is undisputed here. The sale of the Stanhope was made pursuant to a subsequently confirmed plan of reorganization under chapter 11 of the Bankruptcy Code as required by Section 1146(c). Accordingly, the Gains Tax which the Debtor paid under protest was not due.

III. Waiver of Sovereign Immunity

Having found the Section 1146(c) exemption to apply, I must next determine whether the Eleventh Amendment or the doctrine of sovereign immunity precludes the exercise of jurisdiction over New York.[5] There are two well known exceptions to the doctrine of sovereign immunity and the Eleventh Amendment which allow a plaintiff to assert a claim against a state in federal court.[6] These exceptions, which can be

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5 There is a technical distinction between common law sovereign immunity and the constitutional protections of the Eleventh Amendment. Sovereign immunity protects a state from a suit brought by one of its own citizens; a waiver of sovereign immunity goes to "whether" or "when" a state may be sued. The Eleventh Amendment prohibits suits against the several states in federal court and thus speaks to "where" a state may be sued. *See Lawson Burich Assoc., Inc. v. Axelrod (In re Lawson)* 59 Bankr. 681, 687 n.8 (Bankr. S.D.N.Y. 1986). The distinction is not crucial to this decision, as the Second Circuit has held that the waiver intended under section 106 encompasses both sovereign immunity and the protections of the Eleventh Amendment. *See Hoffman v. Connecticut Dep't of Income Maintenance, (In re Willington Convalesence Homes, Inc.)* 850 F.2d 50, 56 n.6 (2d Cir. 1988), *aff'd*, 109 S.Ct. 2818 (1989).

6 A state may also waive its immunity to private causes of action in federal court by enacting its own state statute or constitutional provision, provided the enactment does so in express and unmistakable language. *See Edelman v. Jordan*, 415 U.S. 651, 673, *reh'g denied* 416 U.S. 1000 (1974); *Murray v. Wilson Distilling Co.*, 213 U.S. 151, 171 (1909). New York State has enacted no such statute governing this adversary proceeding.

labeled "waiver by participation" and "waiver by abrogation" are both premised on Congressional legislation and are discussed below.

A. WAIVER BY PARTICIPATION

Waiver by participation occurs when a state engages in a federally sponsored activity in which Congress has made waiver of immunity a necessary condition of state participation. *See Parden v. Terminal Railway of the Alabama State Docks Dep't*, 377 U.S. 184 (1964), *overruled in part, Welch v. Texas Dep't of Highways and Public Transp.*, 483 U.S. 468, 478 (1987).[7] However, before this can occur, the language of the congressional enactment must manifest "a clear intent to condition participation . . . on a State's consent to waive its constitutional immunity." *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 237 (1985), *reh'g denied* 473 U.S. 926 (1985). Mere participation by a state is inadequate, as "[c]onstructive consent is not a doctrine commonly associated with the surrender of constitutional rights. . . ." *Edelman*, 415 U.S. at 673; *accord WJM, Inc. v. Massachusetts Dep't of Public Welfare*, 840 F.2d 996, 1002 (1st Cir. 1988). By using unequivocal language, Congress places a state on notice of the consequence of its participation. Clear notice is required because, although bottomed on a congressional enactment, "the loss of immunity ultimately is grounded in waiver and consent by the State through conduct." *Texaco, Inc., v. Louisiana Land and Exploration Co.*, 113 Bankr. 924, 933 (M.D. La.1990).

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7 In *Welch*, a four justice plurality, joined by a fifth justice concurring in part, overruled *Parden v. Terminal Railway* to the extent it held that Congress could statutorily abrogate Eleventh Amendment immunity through something less than unmistakably clear language. The *Welch* decision, however, did not upset *Parden's* holding that a state's participation in a federal program could give rise to a waiver of immunity. In fact a plurality of the Court has subsequently indicated its acceptance of this principle by stating "[a] State may effectuate a waiver of its constitutional immunity by a state statute or constitutional provision, *or by otherwise waiving its immunity to suit in the context of a particular federal program.*" *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 238 n.1 (1985) (emphasis added).

The waiver of a state's immunity by its participation in a bankruptcy proceeding has long been recognized, not only under the Code, but under the former Bankruptcy Act as well. In *Clark v. Barnard*, 108 U.S. 436, 447-48 (1883) the state was deemed to have waived any Eleventh Amendment immunity when it intervened and asserted a claim to the fund in controversy. Similarly, in *Gardner v. New Jersey*, 329 U.S. 565, 574-75 (1947), *reh'g denied* 330 U.S. 853 (1947), the Court applied the traditional rule that a state which invokes the aid of the bankruptcy court subjects itself to and must abide by the procedures of that court. The Court went on to hold that by filing a proof of claim and seeking its allowance, the "State becomes the actor . . . [and] waives any immunity which it otherwise might have had respecting the adjudication of the claim." *Id.* at 574 (citations omitted). The *Gardner* Court held that in light of the state's participation, there was no collision between Section 77 of the former Bankruptcy Act and the constitutional protections of sovereign immunity. *Id.* More recently, this well established exception to sovereign immunity has been codified in Section 106(a) of the Bankruptcy Code, which was enacted "to prevent a government unit from receiving a 'distribution from the estate without subjecting itself to any liability it has to the estate' arising from the same transaction or occurrence upon which its right to distribution is based." *Prudential Lines, Inc. v. United States Maritime Admin. (In re Prudential Lines, Inc.)*, 79 Bankr. 167, 180 (Bankr. S.D.N.Y. 1987) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 29-30 (1978) *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5815-16, 6274). *See also West Virginia v. Hassett (In re O.P.M. Leasing Serv., Inc.)*, 21 Bankr. 993, 1001 (Bankr. S.D.N.Y. 1982); *Texaco v. Louisiana Land and Exploration Co.*, 113 Bankr. at 934; *Saint Joseph's Hosp. v. Department of Public Welfare (In re Saint Joseph's Hospital)*, 103 Bankr. 643, 650 (Bankr. E.D. Pa. 1989); *In re Lile*, 96 Bankr. 81, 83-84 (Bankr. S.D.Tex. 1989).

B. WAIVER BY ABROGATION

Notwithstanding participation and consent by a state, Congress can abrogate or override Eleventh Amendment immunity by enacting a statute under certain of its plenary powers granted by the Constitution. As with waiver by participation, Congress may abrogate a state's constitutionally secured immunity "only by making its intention unmistakably clear in the language of the statute." *Atascadero*, 473 U.S. at 242; *Dellmuth v. Muth*, ____ U.S. ____, 109 S.Ct. 2397 (1989) (citations omitted). Thus, in *Fitzpatrick v. Bitzer*, 427 U.S. 445 (1976), the Court found that Congress had the authority to abrogate a state's Eleventh Amendment immunity when legislating pursuant to Section 5 of the Fourteenth Amendment. Congress can also abrogate a state's immunity when it enacts statutes pursuant to its Article I powers under the Commerce Clause. *See Pennsylvania v. Union Gas Co.*, ___ U.S. ___, 109 S.Ct. 2273, 2277 (1989). In *Hoffman v. Connecticut Dep't of Income Maintenance*, ____ U.S. ____, 109 S.Ct. 2818, 2824 (1989), the Supreme Court had the opportunity, but expressly declined, to decide whether Congress, under the Bankruptcy Clause of Article I, had the authority to abrogate a state's immunity by enacting section 106 of the Bankruptcy Code.

In *Hoffman*, the State of Connecticut had not filed any claims against the debtor's estate, precluding waiver by participation. The debtor, who sought to recover a money judgment against Connecticut, relied on section 106(c) of the Bankruptcy Code which "binds" governmental units to determinations made by the court. The Supreme Court found, however, that the language of section 106(c) did not make it unmistakably clear that Congress intended to subject a state to monetary recovery (as opposed to declaratory or injunctive relief) when it had not filed a proof of claim. 109 S.Ct. at 2823. Because it found the requisite language of waiver absent, the Court declined to address whether Congress had the authority under the Bankruptcy Clause to abrogate a state's immunity. *Id.* at 2824; *see also Union Gas*, 109 S.Ct. at 2277 (if statutory language does not contain clear expression of intent, constitutional ques-

tion of Congress's authority to abrogate immunity need not be considered).

C. WAIVER OF IMMUNITY IN THIS PROCEEDING

Before applying the concepts of waiver by participation and waiver by abrogation, I must note that the validity of any distinction between the two theories has been called into question. In his dissent in *Union Gas*, Justice Scalia discussed the waiver by participation theory espoused in *Parden v. Terminal Railway* and stated:

> to acknowledge that the Federal Government can make the waiver of state sovereign immunity a condition to the State's action in a field that Congress has authority to regulate, is substantially the same as acknowledging that the Federal Government can eliminate state sovereign immunity in the exercise of its Article I powers . . .

Union Gas, 109 S.Ct. at 2303 (Scalia, J., dissenting) (footnote omitted). To Justice Scalia, there was no more than a semantical difference between saying that Congress abrogated Eleventh Amendment immunity in suits based on certain activity or that the State's participation in that activity constituted a waiver of its privilege. Under either label, Justice Scalia asserted, Congress was attempting to accomplish the same goal of using its Article I powers to circumvent the bar imposed by the Eleventh Amendment. Being of the opinion that Article I does not grant Congress that authority, Justice Scalia maintained neither waiver by participation nor abrogation could be relied on to subject a state to a private cause of action in federal court. *See also Hoffman*, 109 S.Ct. at 2824 (Scalia, J., dissenting) (Congress does not have the authority under the Bankruptcy Clause to override a state's sovereign immunity). Although adopted by several other Justices, Justice Scalia's view did not command a majority of the Court in either *Union Gas* or *Hoffman*, and thus does not disturb the authority relied on in this decision. *See also Texaco v. Louisiana Land*, 113 Bankr. at 935.

The federal statute which furnishes the grounds for waiver of New York's immunity is Section 106 of the Bankruptcy Code. Section 106 provides in pertinent part:

> Waiver of sovereign immunity
>
> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

In their brief and oral argument, both parties focused on the language of section 106(b) and its provisions for offsetting unrelated claims, because New York had not as of that time filed a claim for the Gains Tax. But New York subsequently filed amended claim no. 300, which includes a request for Gains Tax liability and penalties and interest accruing from January 13, 1989 to September 23, 1989. The focus of the waiver argument therefore shifts from section 106(b) to section 106(a), which deals with claims filed by a state arising out of the same transaction for which a debtor seeks monetary recovery.

Consideration of New York's subsequently filed claim is appropriate, as "[w]aivers . . . often control past events." *WJM v. Massachusetts*, 840 F.2d at 1004. In *WJM*, the circuit court discovered that the State of Massachusetts filed related proofs of claim three months after the bankruptcy court heard oral argument but before judgment was entered in the debtor's adversary proceeding seeking a money judgment from the state. It was unclear from the record below whether either the bankruptcy court or the district court on appeal was aware of the related claims having been filed. The circuit court, in response to Massachusetts' Eleventh Amendment defense, held that the subsequent filing of the proofs of claim was tantamount to a declaration by the state that it had waived immunity to suit in federal court. *Id.* at 1004. The *WJM* court further jus-

tified consideration of claims not included in the record below because the issue of sovereign immunity touched upon the jurisdictional scope of appellate court review. Given the likelihood of appeal in a suit of this financial magnitude and the precedent it will set, these same concerns warrant consideration of New York's subsequently filed claim for the Gains Tax.

In no more plain language than it used could Congress have expressed its intention to condition New York's participation and receipt of a distribution in the Debtor's bankruptcy case on a waiver of immunity. By captioning the section "Waiver of Sovereign Immunity", Congress made a direct textual reference to its intent. The Supreme Court, in *dicta*, acknowledged that the language of section 106(a) is carefully crafted to waive sovereign immunity when the state files a proof of claim related to the transaction in controversy. *Hoffman*, 109 S.Ct. at 2822 (plurality opinion); *accord*, *WJM*, 840 F.2d at 1003 (Section 106(a) gives notice that by choosing to file a claim and enter the bankruptcy court's exclusive domain, a state must pay the price of waiving immunity).

Similarly, Congress's intent to abrogate immunity under its Article I powers is beyond serious question, as section 106(a) applies to a very narrow class of entities deemed "government units," which are defined essentially as the federal government, a state or other foreign or domestic government and their agencies. 11 U.S.C.A. § 101 (26) (West Supp.1990). The statute does not authorize suit against *any* potential litigant but addresses only three classes of sovereigns, thereby distinguishing section 106(a) from the overly broad statutes which have been found not to waive immunity. *Compare Atascadero*, 473 U.S. at 246, (no waiver of immunity in statute providing monetary damages against "any recipient of Federal assistance"); *Employees of the Dep't of Public Health and Welfare v. Missouri*, 411 U.S. 279, 283 (1973) (statute allowing suit against "any employer" did not subject state to private cause of action in federal court) *with Union Gas*, 109 S.Ct. at 2278 (statute's express inclusion of "States" within its definition of "Persons" liable for environmental cleanup costs conveyed

message of unmistakable clarity that immunity had been waived).

New York cannot and has not contended that the wording of section 106(a) provides inadequate notice of Congress's intent to condition participation on waiver or to abrogate a state's immunity when a related claim is filed, as no other plausible reading exists. Indeed, New York has conceded that a state can waive its immunity by participating in a bankruptcy proceeding. In its supplemental memorandum of law in support of its motion to dismiss, at p. 14, New York cites to *Gardner v. New Jersey*, 329 U.S. 565, 573 (1947) for the proposition that section 106(a) incorporates the traditional bankruptcy rule that waiver by participation occurs when a state files a proof of claim and demands its allowance. New York admitted, before it filed its claim for the Gains Tax, that it had consented to the adjudication of those taxes for which it had already filed proofs of claim. Supplemental memorandum at 15. This concession, coupled with the subsequent filing of an amended proof of claim for the Gains Tax, is enough to defeat New York's immunity defense. It is therefore unnecessary to reach the constitutional questions which New York had propounded before it filed its amended claims. Similarly, in light of the applicability of section 106(a), I need not address the other statutory grounds which the Debtor asserts as sufficient jurisdictional underpinning to effect a setoff under section 106(b). Accordingly the Debtor's motion for summary judgment is granted and New York is directed to refund the Gains Tax payment made under protest. New York's cross-motion for summary judgment for failure to state a claim is denied.

SETTLE ORDER consistent with this decision.

Dated: New York, New York
July 13, 1990

/s/ TINA L. BROZMAN
United States Bankruptcy Judge

APPENDIX

STATE OF NEW YORK
Department of
Taxation and Finance
Albany, New York 12227
Law Bureau
State Campus,
Albany, New York 12227
September 21, 1983

Dear :

This letter is in reply to your inquiries of June 9 and June 27, 1983 concerning Article 31-B of the Tax Law, the New York Real Property Transfer Gains Tax. You had questions as to the treatment of the tax for State corporate franchise and personal income tax purposes, and as to how the "acquisition of controlling interest" provisions of the tax are to be applied.

In order to determine the deductibility of the gains tax for corporate franchise and personal income tax purposes, the tax must first be classified. The New York State Real Property Transfer Gains Tax is a levy on gains derived from the transfer by any method of an interest in real property located in New York where the consideration is one million dollars or more.

The State gains tax is a transfer tax rather than a property or income tax since the triggering mechanism of the tax is the transfer of real property. Whereas the gains tax is a tax upon the transfer of real property, a property tax is a levy on the property itself. Income taxes are generally applied to net gain. Under the gains tax, the loss from one transfer of real property does not effect the applicability of the gains tax to another transfer of real property in the same tax year. For these reasons, it is our opinion that the State gains tax should be classified as a State transfer tax and should be treated as such for purposes of deductibility.

It should be noted, however, that though the Department's views are expressed herein, the Internal Revenue Service will

ultimately determine the deductibility of the gains tax for Federal tax purposes, and that State tax policy is usually formulated in accordance with the Federal treatment of the tax. It is our opinion, in light of Revenue Ruling 80-121, that the Internal Revenue Service will classify the gains tax as being a transfer tax. In that ruling, Vermont's land gains tax, as imposed by sections 10001 through 10010, Title 32, of the Vermont Statutes Annotated, was deemed to be a transfer tax. The Vermont land gains tax is conceptually similar to New York's gains tax in that the Vermont statute levies a tax on gain from the sale or exchange of land. Under their statute, a sale or exchange of land is any transfer of title to land for a consideration, and taxable gain is the amount realized from a sale or exchange of land, less the transferor's basis in the land.

Section 164(a) of the Internal Revenue Code describes various types of taxes that are allowed as a deduction for the taxable year within which paid or accrued. Specifically allowed are: (1) State and local real property taxes; (2) State and local personal property taxes; (3) State and local income taxes; and (4) State and local general sales taxes. Section 164(a) of the Code also allows, as a deduction, State and local taxes not specifically described that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

In determining that the Vermont land gains tax is a transfer tax, Revenue Ruling 80-121 first distinguished other forms of taxes as not being applicable. The Ruling provides, in pertinent part, as follows:

> "The Vermont land gains tax is not imposed or triggered by the ownership of real property, but rather, by the exercise of one of the incidents of property ownership, the transfer of real property at a gain. The land gains tax is not measured by the value of the real property, but rather, by the gain derived from the transfer of that property . . . . Thus, the land gains tax is not a real property tax within the meaning of section 164(a)(1) of the Code."

With respect to the Vermont land gains tax qualifying as a State income tax within the meaning of section 164(a)(3) of the Code, the Revenue Ruling distinguishes the land gains tax from Federal income taxes, stating that the State tax, unlike the Federal income tax, is not structured to fall on net gain. The taxpayer, as a result of the gains tax, cannot reduce taxable gain from sales or exchanges of land during the taxable year by any losses from other sales or exchanges of land during that year. Under Federal income tax law, taxpayers are allowed to reduce gains from sales or exchanges of land by losses from sales or exchanges of land. Noting that a taxpayer could be required to pay the land gains tax even though under Federal income tax laws that same taxpayer may have a net loss from sales or exchanges of land, the ruling concluded that the tax is not an income tax under section 164(a)(3) of the Code.

In light of Revenue Ruling 80-121, it is the Department's opinion that the New York State Real Property Transfer Gains Tax is a transfer tax, and for purposes of Federal deductibility, the tax is deductible for purposes of computing adjusted gross income under section 164(a) of the Internal Revenue Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business, or in connection with an activity described in section 212 of the Internal Revenue Code relating to expenses for the production of income.

For State income tax purposes, section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means his Federal adjusted gross income, with certain modifications. Since the State gains tax will be deductible for purposes of computing Federal adjusted gross income, it will automatically be excluded from the computation of New York adjusted gross income, since there is no provision in the Tax Law adding back such amounts for purposes of such computation. A similar provision is found in Article 9-A of the Tax Law, the corporate franchise tax. Section 208 defines "entire net income" to mean total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department. Since the State gains tax will be

deducted from the taxable income the taxpayer is required to report to the United States Treasury Department, the tax will automatically be excluded from the computation of the state franchise tax since there is no provision adding it back for purposes of computing entire net income.

With regard to your inquiry as to how the acquisition of controlling interest provisions of the tax are to be applied, one must look to what is acquired, not to what is maintained. The tax is imposed on gains from the transfer of any interest in real property, which is defined to include "acquisition of a controlling interest" in any entity with an interest in real property. (Tax Law, § 1440.7) The term "controlling interest" is defined in section 1440.2 of the Tax law to mean:

> "(i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation, and
> (ii) in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity."

The key term in these provisions is "acquisition". For purposes of the gains tax, if no partner acquires a controlling interest in the partnership, there is no transfer subject to the tax. In the case of a corporation which has an interest in real property, the acquisition of a controlling interest in the corporation occurs when an individual, group of individuals acting in concert to avoid the tax, or another entity becomes the owner of 50% or more of the voting stock in such corporation. Because the statute looks to the acquisition of the controlling interest, it is the act of the transferee which triggers the tax.

For your further information, I am enclosing a copy of Publication 588 containing questions and answers on the gains tax or real property transfers.

Very truly yours,

JOHN P. DUGAN
Deputy Commissioner and Counsel

TWS/cjm
Enclosure

STATE OF NEW YORK
Department of
Taxation and Finance
Albany, New York 12227
Law Bureau
State Campus,
Albany, New York 12227
November 14, 1983

Dear :

This letter is in response to your inquiry of September 23, 1983 regarding Article 31-B of the Tax Law, The New York Real Property Transfer Gains Tax. You asked whether the payment of tax pursuant thereto would avail the taxpayer of a credit or deduction for partnership or individual income tax purposes. It is our opinion that, if anything, a deduction would be allowed.

The treatment of taxes for such purposes largely depends upon the classification of the tax. Comparably classified taxes generally receive similar deduction treatment. The New York State Real Property Transfer Gains Tax is a levy on gains derived from the transfer by any method of an interest in real property located in New York where the consideration is one million dollars or more.

The tax is classified by New York as a transfer tax rather than a property tax because it is triggered by the transfer of the property, not by other incidents of ownership, and not levied on the land itself.

It should be noted, however, that though the Department's views are expressed herein, the Internal Revenue Service will ultimately determine the deductibility of the gains tax for Federal tax purposes, and that State tax policy is usually formulated in accordance with the Federal treatment of the tax. It is our opinion, in light of Revenue Ruling 80-121, that the Internal Revenue Service will classify the gains tax as being a transfer tax. In that ruling, Vermont's land gains tax, as imposed by sections 10001 through 10010, Title 32, of the Vermont

Statutes Annotated, was deemed to be a transfer tax. The Vermont land gains tax is conceptually similar to New York's gains tax in that the Vermont statute levies a tax on gain from the sale or exchange of land. Under their statute, a sale or exchange of land is any transfer of title to land for a consideration, and taxable gain is the amount realized from a sale or exchange of land, less the transferor's basis in the land.

Section 164(a) of the Internal Revenue Code describes various types of taxes that are allowed as a deduction for the taxable year within which paid or accrued. Specifically allowed are: (1) State and local real property taxes; (2) State and local personal property taxes; (3) State and local income taxes; and (4) State and local general sales taxes. Section 164(a) of the Code also allows, as a deduction, State and local taxes not specifically described that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

In determining that the Vermont land gains tax is a transfer tax, Revenue Ruling 80-121 first distinguished other forms of taxes as not being applicable. The Ruling provides, in pertinent part, as follows:

> "The Vermont land gains tax is not imposed or triggered by the ownership of real property, but rather, by the exercise of one of the incidents of property ownership, the transfer of real property at a gain. The land gains tax is not measured by the value of the real property, but rather, by the gain derived from the transfer of that property . . . . Thus, the land gains tax is not a real property tax within the meaning of section 164(a)(1) of the Code."

With respect to the Vermont land gains tax qualifying as a State income tax within the meaning of section 164(a)(3) of the Code, the Revenue Ruling distinguishes the land gains tax from Federal income taxes, stating that the State tax, unlike the Federal income tax, is not structured to fall on net gain. The taxpayer, as a result of the gains tax, cannot reduce taxable gain from sales or exchanges of land during the taxable year by any

losses from other sales or exchanges of land during that year. Under Federal income tax law, taxpayers are allowed to reduce gains from sales or exchanges of land by losses from sales or exchanges of land. Noting that a taxpayer could be required to pay the land gains tax even though under Federal income tax laws that same taxpayer may have a net loss from sales or exchanges of land, the ruling concluded that the tax is not an income tax under section 164(a)(3) of the Code.

In light of Revenue Ruling 80-121, it is the Department's opinion that the New York State Real Property Transfer Gains Tax is a transfer tax, and for purposes of Federal deductibility, the tax is deductible for purposes of computing adjusted gross income under section 164(a) of the Internal Revenue Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business, or in connection with an activity described in section 212 of the Internal Revenue Code relating to expenses for the production of income.

For State income tax purposes, section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means his Federal adjusted gross income, with certain modifications. Since the State gains tax will be deductible for purposes of computing Federal adjusted gross income, it will automatically be excluded from the computation of New York adjusted gross income, since there is no provision in the Tax Law adding back such amounts for purposes of such computation. A similar provision is found in Article 9-A of the Tax Law, the corporate franchise tax. Section 208 defines "entire net income" to mean total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department. Since the State gains tax will be deducted from the taxable income the taxpayer is required to report to the United States Treasury Department, the tax will automatically be excluded from the computation of the state franchise tax since there is no provision adding it back for purposes of computing entire net income.

For your further information, I am enclosing a copy of Publication 588 containing questions and answers on the gains tax or real property transfers.

Very truly yours,

JOHN P. DUGAN
Deputy Commissioner and Counsel

LMP:pbc
Enclosure

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket Number: 91-5038

FILED MAY 29, 1992

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of May, one thousand nine hundred and ninety-two.

IN RE: 995 FIFTH AVENUE ASSOCIATES, L.P.,

Debtor.

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995 FIFTH AVENUE ASSOCIATES, L.P.,

Plaintiff-Appellee,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, as Commissioner of Taxation and Finance; EDWARD V. REGAN, as Comptroller of the State of New York,

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Plaintiff-Appellee 995 Fifth Avenue Associates, L.P.

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/ ELAINE B. GOLDSMITH
Elaine B. Goldsmith,
Clerk

UNITED STATES CODE

Title 11 Bankruptcy

§ 1146. Special tax provisions

* * *

(c) The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

* * *

CODE OF ALABAMA

Title 40 Revenue and Taxation

Chapter 22 Recordation Tax

§ 40-22-1. Deeds, bills of sale, etc.

No deed, bill of sale or other instrument of like character which conveys any real or personal property within this state or which conveys any interest in any such property, except the transfer of mortgages on real or personal property within this state upon which the mortgage tax has been paid, deeds or instruments executed for a nominal consideration for the purpose of perfecting the title to real estate, the re-recordation of corrected mortgages, deeds or instruments executed for the purpose of perfecting the title to real or personal property, specifically, but not limited to, corrections of maturity dates thereof, and deeds and other instruments or conveyances, executed prior to October 1, 1923, shall be received for record unless the following privilege or license tax shall have been paid upon such instrument before the same is offered for record: Upon all such instruments which are executed to convey real or personal property situated in this state of the value of $500.00 or less there shall be paid the sum of $.50, and upon all such instruments executed to convey real or personal property situated in this state of more than $500.00 in value there shall be paid the sum of $.50 for each $500.00 or fraction thereof in value of property conveyed by such instrument; provided, that only the value in excess of any mortgages or vendor's lien upon any property within this state on which the mortgage tax has been paid shall be taxable under this section; and provided further, that where several deeds or instruments are executed by tenants in common for the same consideration, only one of such instruments shall be taxable under this section.

* * *

DELAWARE CODE

Title 30 State Taxes

Chapter 54 Realty Transfer Tax

§ 5402. Rate of tax; when payable; exception

(a) Every person who makes, executes, delivers, accepts or presents for recording any document, except as defined or described in § 5401(4) of this title, or in whose behalf any document is made, executed, delivered, accepted or presented for recording shall be subject to pay for and in respect to the transaction, or any part thereof, a realty transfer tax at the rate of 2 percent of the value of the property represented by such document, which tax shall be payable at the time of making, execution, delivery, acceptance or presenting of such document for recording. Said tax is to be apportioned equally between grantor and grantee.

(b) No tax shall be imposed on conveyances when the actual value of the property being transferred is less than $100.

(c) Notwithstanding subsection (a) of this section, where a valid written contract is entered into prior to August 1, 1971, the tax for such a transfer shall be at the rate imposed prior to August 1, 1971.

(d) Every person who makes, executes, delivers, accepts or presents for recording any document defined or described in § 5401(4) of this title, or in whose behalf any such document is made, executed, delivered, accepted or presented for recording shall be subject to pay for and in respect to the transaction, or in any part thereof, a realty transfer tax at the rate of 2 percent of the value of the property represented by such document, which tax shall be payable as follows:

(1) The tax on the consideration attributed to the first year of the term shall be payable at the time of making, execution, delivery, acceptance or presenting of such document for recording;

(2) The tax on the consideration attributed to each successive year of the term thereafter shall be paid annually to the Division of Revenue.

(e) There shall be no tax imposed on any document described in § 5401(4) of this title entered into prior to July 7, 1973.

(f) Notwithstanding subsection (a) of this section, the rate of tax on documents described in § 5401(8) of this title shall be 1% on amounts exceeding $10,000, which shall be borne by the owner of the building whose construction is made subject to tax under § 5401(8).

ILLINOIS STATUTES

Chapter 120 Revenue

Real Estate Transfer Tax Act

1003. Imposition—Amount—Collection—Proceeds—Stamps—Declaration of buyer and seller

§ 3. A tax is imposed on the privilege of transferring title to real estate, as represented by the deed that is filed for recordation, and on the privilege of transferring a beneficial interest in real property which is the subject of a land trust as represented by the trust document that is filed for recordation, at the rate of 50¢ for each $500 of value or fraction thereof stated in the declaration provided for in this Section. If, however, the real estate is transferred subject to a mortgage the amount of the mortgage remaining outstanding at the time of transfer shall not be included in the basis of computing the tax.

* * *

MASSACHUSETTS GENERAL LAWS

Title IX Taxation

Chapter 64D. Excise on Deeds, Instruments and Writings

§ 1. Rate of taxation; instrument excepted

There shall be levied, collected and paid, for and in respect of the deeds, instruments and writings hereinafter mentioned and described, or for or in respect of the vellum, parchment or paper upon which such deeds, instruments or writings, or any of them, are written or printed, the excise taxes herein specified:— Deed, instrument or writing, whereby any lands, tenements or other realty sold shall be granted, assigned, transferred or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her or their direction, when the consideration of the interest or property conveyed exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds one hundred dollars and does not exceed five hundred dollars, one dollar, and for each additional five hundred dollars or fractional part thereof, one dollar. Notwithstanding any other provisions of this section or any other general or special law to the contrary, Nantucket county may disburse and expend deposits in said Funds for the purpose of facilities and programs related to law enforcement, including the planning, improving or constructing of police stations and other related facilities and programs. This chapter shall not apply to any instrument or writing given to secure a debt or to any deed, instrument or writing to which the commonwealth, a city or town of the commonwealth, or the United States or any of their agencies are a party.

MINNESOTA STATUTES

Deed Tax

§ 287.21. Imposition of tax; determination of tax

Subdivision 1. There is hereby imposed on each deed, instrument, or writing by which any lands, tenements, or other realty in this state shall be granted, assigned, transferred or otherwise conveyed, a tax determined in the following manner. When transfers are made by instruments pursuant to mergers, consolidations, sales or transfers of substantially all of the assets of corporations pursuant to plans of reorganization or there is no consideration or when the consideration, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, is $500 or less, the tax shall be $1.65. When the consideration, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $500, the tax shall be $1.65 plus $1.65 for each additional $500 or fraction of that amount.

The tax applies against the total consideration, including the fair market value consideration for any personal property located on the real property conveyed by the deed and transferred as part of the total consideration, but excluding the value of any lien or encumbrance remaining on the property at the time of sale.

* * *

NEW YORK REAL PROPERTY ACTIONS & PROCEEDINGS LAW

Article 13—Action to Foreclose a Mortgage

§ 1354. Distribution of proceeds of sale

1. The officer conducting the sale shall pay, out of the proceeds, unless otherwise directed, the expenses of the sale, and pay to the plaintiff, or his attorney, the amount of the debt, interest and costs, or so much as the proceeds will pay and take the receipt of the plaintiff, or his attorney, for the amount so paid, and file the same with his report of sale.

2. The officer conducting the sale shall pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments, and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. In any city having a population of one million or more, such officer shall pay out of the proceeds any liens or encumbrances placed by a city agency upon the real property which have priority over the foreclosed mortgage. The sums necessary to make those payments and redemptions are deemed expenses of the sale. The provisions of this subdivision shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder.

3. The officer conducting the sale after fully complying with the provisions of subdivisions one and two of this section and if the judgment of sale has so directed shall pay to the holder of any subordinate mortgage or his attorney from the then remaining proceeds the amount then due on such subordinate mortgage, or so much as the then remaining proceeds will pay and take the receipt of the holder, or his attorney for the amount so paid, and file the same with his report of sale.

4. When the sum of the amount of the proceeds before any distributions are made under this section and the amount of any

other liens which the real property is taken subject to is one million dollars or more, the officer conducting the sale shall pay, out of the proceeds remaining after the provisions of subdivisions one, two and three of this section have been complied with, the amount of tax on gains derived from certain real property transfers due from the defendant pursuant to article thirty-one-B of the tax law to the state tax commission. Such amount shall be ten per centum of the sum of the amount of the proceeds before any distributions are made under this section and the amount of any other liens which the real property is taken subject to, unless the defendants shall furnish the officer conducting the sale a statement of tentative assessment or statement of no tax due issued by the state tax commission, in which case the officer shall pay over to the state tax commission the amount stated on such tentative assessment or statement of no tax due. The officer conducting the sale shall, along with such payment, file returns and information in accordance with procedures established by the state tax commission.

5. All surplus moneys arising from the sale shall be paid into court by the officer conducting the sale within five days after the same shall be received.

NEW YORK TAX LAW

Article 31—Real Estate Transfer Tax

§ 1402. Imposition of tax

A tax is hereby imposed on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars, at the rate of two dollars for each five hundred dollars or fractional part thereof; provided, however, that with respect to (A) a conveyance of a one, two or three-family house and an individual residential condominium unit, or interest therein; and (B) conveyances where the consideration is less than five hundred thousand dollars, the consideration for the interest conveyed shall exclude the value of any lien or encumbrance remaining thereon at the time of conveyance.

Article 31-B–Tax on Gains Derived from Certain Real Property Transfers

§ 1440. Definitions

In this article:

1. (a) "Consideration" means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation.

(b) In the case of (i) the granting of an option with use and occupancy of real property or (ii) the creation of a leasehold or sublease that is a transfer of real property, as defined in sub-

division seven of this section, consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein and the value of any option to purchase or renew included in such transfer.

(c) In the case of a transfer which includes other assets which are in addition to real property or an interest therein and for which there is no reasonable apportionment of the consideration for such real property or interest, consideration means that portion of the total consideration which represents the fair market value of such real property or interest. In the case of a transfer of a controlling interest in an entity with an interest in real property, there shall be an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest.

2. "Controlling interest" means (i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation, and (ii) in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity.

3. "Gain" means the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price.

4. "Interest" when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. Interest shall also include an option or contract to purchase real property.

5. (a) "Original purchase price" means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission.

(b) In the case of a transfer of real property by a gift, devise, bequest or inheritance, the original purchase price of the real property in the hands of the transferee immediately after the transfer shall be the same as the original purchase price of such property in the hands of the transferor immediately before the transfer.

(c) The transferee of every transfer of real property for which exemption is granted, pursuant to subdivision one of section fourteen hundred forty-three of this article on the basis that no consideration was paid for such transfer, shall be bound by a determination of original purchase price as determined under paragraph (b) of this subdivision, if such transferee participated in filing the form upon which such exemption was granted.

(d) In the case of the creation of a lease or option with use and occupancy, the original purchase price means the amount described in paragraph (a) of this subdivision which relates to the real property or interest therein which is being leased, multiplied by a fraction, the numerator of which is the value of the rental payments under the lease plus the amount paid for an option, if any, and the denominator of which is the fair market value of the real property.

(e) The consideration, described in paragraph (b) of subdivision one of this section, received by the lessor of a taxable lease shall become such lessor's original purchase price of the interest in the real property leased; provided, that such lessor paid the tax imposed by this article on such lease or is paying such tax pursuant to the installment payment provisions of section fourteen hundred forty-two of this article.

(f) In the case of the creation of a sublease, original purchase price includes the value of the remaining rental payments required to be made pursuant to the terms of the prime lease during the term of such sublease.

(g) In the case of a transfer of a controlling interest in an entity with an interest in real property, there shall be an apportionment of the original purchase price of the interest in real property to the controlling interest for the purpose of ascertaining the original purchase price of such controlling interest.

6. "Real property" means every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings, structures and other improvements thereon and leaseholds, which are located in whole or in part within the state. For purposes of this article, there shall be apportionments of consideration and original purchase price in connection with the transfer of real property located partly within the state and partly without the state.

7. "Transfer of real property" means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or

sublease is for substantially all of the premises constituting the real property. Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article, and the transfer of real property by tenants in common, joint tenants or tenants by the entirety, provided that the subdividing of real property and the sale of such subdivided parcels improved with residences to tranferees for use as their residences, other than transfers pursuant to a cooperative or condominium plan, shall not be deemed a single transfer of real property. For purposes of this article, transfers pursuant to a cooperative plan shall include all transfers of stock in a cooperative corporation which owns real property. Notwithstanding the foregoing, transfer of real property shall not include a transfer pursuant to devise, bequest or inheritance; the creation, modification, extension, spreading, severance, consolidation, assignment, transfer, release or satisfaction of a mortgage, a mortgage subordination agreement, a mortgage severance agreement, an instrument given to perfect or correct a recorded mortgage; or a release of lien of tax pursuant to this chapter or the internal revenue code of nineteen hundred fifty-four, as amended.

8. "Person" means an individual, corporation, partnership, association, trust, estate or other entity, or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee, or member is under a duty to perform an act required under this article.

9. "Person liable for the tax" means a person who is personally liable for the tax whether as a tranferor or as a transferee pursuant to paragraph (a) of subdivision three of section fourteen hundred forty-seven of this article.

§ 1441. Imposition of tax

A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain.

§ 1447. Filings and procedures

* * *

1. (f)(1) A county clerk or register of a county shall not record or accept for record any conveyance, other than a conveyance by a court of appropriate jurisdiction, or an officer thereof, resulting from an action to foreclose a mortgage, of real property in New York state, unless accompanied by:

(i) the statement of tentative assessment of the amount of tax or statement that no tax is due provided pursuant to subdivision two of this section, together with the payment of the tentative assessment of the amount of tax, if any, or

(ii) an affidavit, or other form prescribed by the state tax commission, fully executed under penalty of perjury, affirming (A) that the transfer of real property is exempt under subdivision seven of section fourteen hundred forty-three of this article or (B) that the transfer is a transfer of real property where the consideration is less than five hundred thousand dollars and is not a partial or successive transfer of real property or (C) that the transfer is a transfer of real property by tenants in common, joint tenants or tenants by the entirety where the aggregate consideration is less than five hundred thousand dollars or (D) that the conveyance is not a transfer of real property within the meaning of subdivision seven of section fourteen hundred forty of this article, together with documents supporting such claim, or (E) that the transferor is exempt under paragraph (a) or (b) of subdivision three of section fourteen hundred forty-three of this article or (F) that the transfer of real property is exempt under subdivision two of section fourteen hundred forty-three of this article.

* * *

3. (a) Whenever the transferor or transferee shall fail to give such pertinent affidavits and other information to the department of taxation and finance as required by this section, or whenever such department shall inform the transferee that a tentative assessment of such tax exists, any sums of money, property or other consideration, which the transferee is required to transfer over to the transferor shall be subject to a first priority right for any such taxes stated to be due from the transferor to the state in such tentative assessment, and (except as provided in paragraphs (b) and (c) of this subdivision) the transferee is forbidden to transfer to the transferor any such sums of money, property or consideration to the extent of the amount of the state's claim stated in such tentative assessment, whether or not the transferor has represented to, or informed the transferee that, he owes any tax pursuant to this article, and whether or not the transferee has knowledge that such taxes are owing, and whether any such taxes are in fact owing. Whenever the department shall fail to give such statement of a tentative assessment of such tax to the transferor and the transferee, within twenty days from receipt of such pertinent affidavits and such other information, such failure will release the transferee from any further obligation to withhold any sums of money, property or other consideration, which the transferee is required to transfer over to the transferor; except that with respect to matters pending on the effective date of this article such twenty day period shall not begin to run until ninety days after the effective date of this article. For the transferee's failure to comply with the provisions of this subdivision, the transferee (except as provided in paragraphs (b) and (c) of this subdivision) shall be personally liable for the payment to the state of any such taxes stated in such tentative assessment to be due to the state from the transferor; provided, however, in a case where no tentative assessment has been issued because the transferee did not file the required questionnaire, or the transferee supplies willfully false or fraudulent information, the transferee shall be personally liable for the taxes stated to be due in a notice of determination, except that the liability of the transferee shall be further limited to the sums of money, prop-

erty or other consideration which the transferee is required to transfer over to the transferor, and such liability may be assessed and enforced in the same manner as the liability for tax under this article. Upon receipt of such statement of tentative assessment mailed or delivered within the twenty days as aforesaid of the notice of the stated amount of the state's claim from the department, and demand for payment thereof, the transferee may make payment of such claim to the state from any sums of money, property, or consideration withheld in accord with the provisions of this paragraph, except that such payment shall be limited to the sums of money, property or other consideration which the transferee is required to transfer over to the transferor, and upon making the payment, such transferee shall be relieved of all liability for such amounts to the transferor, and such amounts paid to the state shall be deemed satisfaction of the tax liability of the transferor, to the extent of the amount of such payment.

(b) Notwithstanding paragraph (a) of this subdivision, the transferee in an action to foreclose a mortgage is not forbidden to transfer the consideration to the officer conducting the sale, and the transferee shall be released from personal liability for taxes determined to be due from the mortgagor under this article.

(c) Notwithstanding paragraph (a) of this subdivision, the transferee is not forbidden to transfer the consideration to the transferor and the transferee shall be released from personal liability where a bond issued by a surety company approved by the superintendent of insurance as to solvency and responsibility and authorized to transact business in the state and acceptable to the tax commission is filed with such commission conditioned upon payment of the balance of tax due on which the transferee is liable.

(d) Where the liability of a transferee, for the payment to the state of any such taxes determined to be due from the transferor, has been wholly paid or satisfied or no longer exists, the tax commission shall mail to such transferee a notice, addressed to his last known address, setting forth that such lia-

bility has been wholly paid or satisfied or no longer exists. The tax commission shall include in such notice the following additional information:

(1) the name and last known address of the transferee;

(2) the amount of the tax paid, satisfied or vacated; and

(3) a statement to the effect that consumer reporting agencies must delete from a credit file any reference to the particular tentative tax assessment within thirty days of receipt from the transferee of such notice. Provided, however, no order or decree in a bankruptcy proceeding shall be construed as giving rise to the requirement that the notice provided for in this paragraph be given.

ADMINISTRATIVE CODE AND CHARTER OF THE CITY OF NEW YORK

Chapter 21 Real Property Transfer Tax

§ 11-2102 Imposition of tax. a. A tax is hereby imposed on each deed at the time of delivery by a grantor to a grantee when the consideration for the real property and any improvement thereon (whether or not included in the same deed) exceed twenty-five thousand dollars. The tax shall be:

* * *

(9) with respect to conveyances made on or after August first, nineteen hundred eighty-nine (other than grants, assignments or surrenders of leasehold interests in real property taxable as provided in paragraph ten of this subdivision), the tax shall be at the following rates:

(i) at the rate of one percent of the consideration for conveyances of one, two or three-family houses and individual residential condominium units where the consideration is five hundred thousand dollars or less, and at the rate of one and four hundred twenty-five thousandths of one percent of the consideration for such conveyances where the consideration is more than five hundred thousand dollars, and

(ii) at the rate of one and four hundred twenty-five thousandths of one percent of the consideration with respect to all other conveyances where the consideration is five hundred thousand dollars or less, and at the rate of two and six hundred twenty-five thousandths of one percent where the consideration for such conveyances is more than five hundred thousand dollars:

(10) With respect to a grant, assignment or surrender of a leasehold interest in real property made on or after August first, nineteen hundred eighty-nine, the tax shall be at the following rates:

(i) at the rate of one percent of the consideration for the granting, assignment or surrender of a leasehold interest in a one, two or three-family house or an individual dwelling unit in a dwelling which is to be occupied or is occupied as the residence or home of four or more families living independently of each other where the consideration is five hundred thousand dollars or less, and at the rate of one and four hundred twenty-five thousandths of one percent of the consideration where the consideration for granting, assignment or surrender or such leasehold interest is more than five hundred thousand dollars, and

(ii) at the rate of one and four hundred twenty-five thousandths of one percent of the consideration for the granting, assignment or surrender of a leasehold interest in all other real property where the consideration is five hundred thousand dollars or less, and at the rate of two and six hundred twenty-five thousandths of one percent of the consideration where the consideration for the granting, assignment or surrender of such a leasehold interest is more than five hundred thousand dollars;

(iii) provided, however, that for purposes of subparagraphs (i) and (ii) of this paragraph, the amount subject to tax in the case of a grant of a leasehold interest shall be only such amount as is not considered rent for purposes of the tax imposed by chapter seven of this title.

* * *

PENNSYLVANIA STATUTES

Article XI-C. Realty Transfer Tax

§ 8102-C. Imposition of tax

Every person who makes, executes, delivers, accepts or presents for recording any document or in whose behalf any document is made, executed, delivered, accepted or presented for recording, shall be subject to pay for and in respect to the transaction or any part thereof, or for or in respect of the vellum parchment or paper upon which such document is written or printed, a State tax at the rate of one per cent of the value of the real estate represented by such document, which State tax shall be payable at the earlier of the time the document is presented for recording or within thirty days of acceptance of such document or within thirty days of becoming an acquired company.

PHILADELPHIA CODE

Chapter 19-1400 Realty Transfer Tax

§ 19-1403. Imposition of Tax—(1) Every person who transfers ownership of real estate situate within the City or who makes, executes, delivers, accepts or presents for recording any document or in whose behalf any document is made, executed, delivered, accepted or presented for recording, or who accepts ownership of real estate situate within the City, shall be subject to pay for and in respect to the transaction or any part thereof, or for or in respect of the vellum parchment or paper upon which such document is written or printed, a tax based on the value of the real estate represented by such document, which tax shall be payable at the earlier of the time the document is presented for recording or within thirty (30) days of acceptance of such document or within thirty (30) days of becoming an acquired real estate company or family farm corporation. For documents made, executed, delivered or accepted or presented for recording during each of the following fiscal years, the amount of tax shall be computed by multiplying the value of the real estate represented by such document by the following rates of tax:

(a) four and seven one-hundredths percent (4.07%) for the fiscal year of the City commencing July 1, 1988 and ending June 30, 1989. Provided that, in the event that a court of competent jurisdiction enters a final order from which all appeals have been exhausted, determining that City Council lacked the authority to impose this rate effective July 1, 1988, the rate shall revert to two and one-half percent (2.5%) for the fiscal year commencing July 1, 1988 and ending June 30, 1989;

(b) four and seven one-hundredths percent (4.07%) for the fiscal year of the City commencing July 1, 1989 and ending June 30, 1990;

(c) three and ninety-two one-hundredths percent (3.92%) for the fiscal year of the City commencing July 1, 1990 and ending June 30, 1991;

(d) three and sixty-nine one-hundredths percent (3.69%) for the fiscal year of the City commencing July 1, 1991 and ending June 30, 1992;

(e) three and forty-six one-hundredths percent (3.46%) for the fiscal year of the City commencing July 1, 1992 and ending June 30, 1993;

(f) three and twenty-three one-hundredths percent (3.23%) for the fiscal year of the City commencing July 1, 1993 and ending June 30, 1994; and

(g) three percent (3.0%) for the fiscal years of the City commencing July 1, 1994 and thereafter.

(2) The payment of the tax imposed herein shall be evidenced by the affixing of an official stamp or writing by the recorder whereon the date of the payment of the tax, amount of the tax and the signature of the collecting agent shall be set forth.

VERMONT STATUTES

Title 32 Taxation and Finance

Chapter 231 Property Transfer Tax

§ 9602. Tax on transfer of title to property

A tax is hereby imposed upon the transfer by deed of title to property located in this state. The amount of the tax equals one and one quarter percent of the value of the property transferred, or $1.00, whichever is greater, except as follows:

(1) with respect to the transfer of property to be used for the principal residence of the transferee the tax shall be imposed at the rate of five-tenths of one percent of the first $100,000.00 in value of the property transferred and at the rate of one and one quarter percent of the value of the property transferred in excess of $100,000.00;

(2) with respect to the transfer of property which is enrolled at the time of the transfer in a program under chapter 124 of this title, or is otherwise a working farm at the time of the transfer if not so enrolled, the tax shall be imposed in the amount of five-tenths of one percent on the entire value of the property transferred; provided, however that no part of the property is converted to a use which would subject it to the land use change tax or an obligation to repay property tax benefits under chapter 124 of this title for a period of three years following the date of the transfer, or if it is a working farm which is not enrolled under chapter 124, that the property is not taken out of agricultural production for a period of six years following the date of the transfer. For the purposes of this subdivision, a working farm shall mean a parcel of land in excess of 25 acres, actively used by a farmer, as that term is defined under section 3752(7) of this title. If the conditions of this subdivision are breached by the buyer, the buyer shall be obligated to pay the full transfer tax in the amount of one percent and this obligation shall run with the land.

WASHINGTON CODE

Title 82 Excise Taxes

Chapter 82.45 Excise Tax on Real Estate Sales

§ 82.45.060. Tax imposed on sale of property—Additional tax imposed

(1) There is imposed an excise tax upon each sale of real property at the rate of one and twenty-eight one-hundredths percent of the selling price. An amount equal to seven and seven-tenths percent of the proceeds of this tax to the state treasurer shall be deposited in the public works assistance account created in RCW 43.155.050.

(2) There is imposed an additional excise tax through June 30, 1989, upon each sale of real property at the rate of six one-hundredths of one percent of the selling price. The tax imposed under this subsection shall be deposited in the conservation area account under RCW 79.71.110.

Chapter 84.46—Counties and Cities—Excise Tax on Real Estate Sales

§ 82.46.010. Tax on sale of real property authorized—Limitations on use—Additional tax authorized—Maximum rates

(1) The governing body of any county or any city may impose an excise tax on each sale of real property in the unincorporated areas of the county for the county tax and in the corporate limits of the city for the city tax at a rate not exceeding one-quarter of one percent of the selling price. The revenues from this tax shall be used by the respective jurisdictions for local capital improvements, including those listed in RCW 35.43.040.

After July 1, 1990, revenues generated from the tax imposed under this subsection in counties and cities that are required or choose to plan under RCW 36.70A.040 shall be used primarily

for financing capital projects specified in a capital facilities plan element of a comprehensive plan and housing relocation assistance under RCW 59.18.440 and 59.18.450. However, revenues (a) pledged by such counties and cities to debt retirement prior to July 1, 1990, may continue to be used for that purpose until all outstanding debt is retired, or (b) committed prior to July 1, 1990, by such counties or cities to a capital project may continue to be used for that purpose until the project is completed.

(2) In lieu of imposing the tax authorized in RCW 82.14.030(2), the governing body of any county or any city may impose an additional excise tax on each sale of real property in the unincorporated areas of the county for the county tax and in the corporate limits of the city for the city tax at a rate not exceeding one-half of one percent of the selling price.

(3) Taxes imposed under this section shall be collected from persons who are taxable by the state under chapter 82.45 RCW upon the occurrence of any taxable event within the unincorporated areas of the county or within the corporate limits of the city, as the case may be.

(4) Taxes imposed under this section shall comply with all applicable rules, regulations, laws, and court decisions regarding real estate excise taxes as imposed by the state under chapter 82.45 RCW.

(5) As used in this section, "city" means any city or town.

§ 82.46.035. Additional tax—Certain counties—Ballot proposition—Use limited to capital projects—Temporary rescindment for noncompliance

(1) The governing body of any county or any city that plans under RCW 36.70A.040(1) may impose an additional excise tax on each sale of real property in the unincorporated areas of the county for the county tax and in the corporate limits of the city for the city tax at a rate not exceeding one-quarter of one percent of the selling price. Any county choosing to plan under

RCW 36.70A.040(2) and any city within such a county may only adopt an ordinance imposing the excise tax authorized by this section if the ordinance is first authorized by a proposition approved by a majority of the voters of the taxing district voting on the proposition at a general election held within the district or at a special election within the taxing district called by the district for the purpose of submitting such proposition to the voters.

(2) Revenues generated from the tax imposed under subsection (1) of this section shall be used by such counties and cities solely for financing capital projects specified in a capital facilities plan element of a comprehensive plan.

(3) Revenues generated by the tax imposed by this section shall be deposited in a separate account.

(4) As used in this section, "city" means any city or town.

(5) When the governor files a notice of noncompliance under RCW 36.70A.340 with the secretary of state and the appropriate county or city, the county or city's authority to impose the additional excise tax under this section shall be temporarily rescinded until the governor files a subsequent notice rescinding the notice of noncompliance.

§ 82.46.070. Additional excise tax—Acquisition and maintenance of conservation areas

(1) Subject to subsection (2) of this section, the legislative authority of any county may impose an additional excise tax on each sale of real property in the county at a rate not to exceed one percent of the selling price. The proceeds of the tax shall be used exclusively for the acquisition and maintenance of conservation areas.

The taxes imposed under this subsection shall be imposed in the same manner and on the same occurrences, and are subject to the same conditions, as the taxes under chapter 82.45 RCW, except:

(a) The tax shall be the obligation of the purchaser; and

(b) The tax does not apply to the acquisition of conservation areas by the county.

The county may enforce the obligation through an action of debt against the purchaser or may foreclose the lien on the property in the same manner prescribed for the foreclosure of mortgages.

The tax shall take effect thirty days after the election at which the taxes are authorized.

(2) No tax may be imposed under subsection (1) of this section unless approved by a majority of the voters of the county voting thereon for a specified period and maximum rate after:

(a) The adoption of a resolution by the county legislative authority of the county proposing this action; or

(b) The filing of a petition proposing this action with the county auditor, which petition is signed by county voters at least equal in number to ten percent of the total number of voters in the county who voted at the last preceding general election.

The ballot proposition shall be submitted to the voters of the county at the next general election occurring at least sixty days after a petition is filed, or at any special election prior to this general election that has been called for such purpose by the county legislative authority.

(3) A plan for the expenditure of the excise tax proceeds shall be prepared by the county legislative authority at least sixty days before the election if the proposal is initiated by resolution of the county legislative authority, or within six months after the tax has been authorized by the voters if the proposal is initiated by petition. Prior to the adoption of this plan, the elected officials of cities located within the county shall be consulted and a public hearing shall be held to obtain public input. The proceeds of this excise tax must be expended in conformance with this plan.

(4) As used in this section, "conservation area" has the meaning given under RCW 36.32.570.

No. 92-363

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

995 FIFTH AVENUE ASSOCIATES, L.P.,

Petitioner,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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BRIEF IN OPPOSITION

Respondents New York State Department of Taxation and Finance, James W. Wetzler, Commissioner of Taxation And Finance, and Edward V. Regan, Comptroller of the State of New York ("respondents"), respectfully submit this brief in opposition to the petition for certiorari.[1] The petition should be

1 Respondents were served with the motion of L.A. Cotton & Co, Inc. and its sole successor in interest, Linda A. Gutterman for leave to file a brief *amicus curiae* on September 25, 1992. Respondents did not consent to the motion for leave to file an *amicus curiae* brief. The motion should be denied for the following reasons: 1) movants' interests are adequately represented by petitioner; 2) the issues raised in the motion were raised by petitioner before the court of appeals, which did not rule on them; and 3) to the extent that these issues are of constitutional dimension, it is not necessary for them to resolved in this case, since the court of appeals correctly decided the issue solely on principles of statutory construction.

denied because it does not present a conflict among the courts of appeals and does not raise an important federal question of national significance which should be settled by this Court.

Statement of the Case

Respondents adopt the statement of the case presented in the opinion of the Court below (3a-4a)[2], as well as in the petition. (2-5).

The court of appeals held that petitioner is not entitled to an exemption from the Tax on Gains Derived From Certain Real Property Transfers, New York Tax Law § 1440 *et seq.* (McKinney 1987), as amended, ("gains tax") because the gains tax is not a stamp or similar tax within the meaning of 11 U.S.C. § 1146(c).[3] The court thus reversed the order of the district court insofar as it directed New York to refund gains tax paid by petitioner. (21a).

In reaching this conclusion, the court analyzed the types of taxes from which Congress intended to exempt qualifying debtors when it enacted 11 U.S.C. § 1146(c), and stated that, since "[t]he Bankruptcy Code supplies no definitions for the terms 'stamp tax' or 'similar tax' . . . we must look to the legislative history for assistance in determining what Congress meant by the phrase 'stamp tax or similar tax.' (12a). The court concluded that ". . . [a]lthough the legislative history shows that the scope of the § 1146(c) tax exemption has expanded since its original enactment in 1934, it fails to indicate whether the New York gains tax qualifies as a 'stamp tax or similar tax'." (14a). The court thus interpreted the words used by

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2 References to the Petition and the Appendix are cited as (" ") and ("___a"), respectively.

3 Bankruptcy Code § 1146(c), 11 U.S.C. § 1146(c) provides:

§ 1146. Special Tax provisions.

(c) The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

Congress, "stamp tax or similar tax" in accordance with "their ordinary, contemporary, common meaning." (*Id.*) (Citations omitted.)

Analysis of the ordinary and common meaning of a stamp or similar tax indicates that there are five essential elements present in those taxes:

> (1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is determined by the consideration for, par value of, or value of the item being transferred; (3) the tax rate is a relatively small percentage of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state documentary transfer taxes, the tax must be paid as a prerequisite to recording. (18a).

The court of appeals found that there were at least "three important differences between the New York gains tax and stamp and documentary transfer taxes"—the gains tax liability is always contingent on the profitability of the underlying transaction; the consideration for the sale is not determinative of the amount; and the tax rate provided in the New York Tax Law, ten percent of the gain, greatly exceeds the tax rate used in any stamp tax or documentary transfer tax. The court thus concluded that although the gains tax bears some resemblance to stamp or similar taxes, it is not a stamp or similar tax within the meaning of 11 U.S.C. § 1146(c). (20a).

REASONS FOR DENYING THE WRIT

The question presented in the petition is whether under section 1146(c) of the Bankruptcy Code the New York State gains tax is a "stamp or similar tax" from which a Chapter 11 debtor is exempt. (i). Petitioner does not assert a conflict among the circuits as to this issue, because there is none. Nor, as petitioner claims, is there a real conflict between the court of

appeals and the "approach taken by courts across the nation." (5). The issues raised in "the courts across the nation" addressed 1) whether the stamp or similar tax can be imposed on the purchaser or transferee, *see CCA Partnership v. Director of Revenue*, (*In re CCA Partnership*), 70 B.R. 696 (Bankr. D. Del.), *aff'd*, 72 B.R. 765 (D. Del.), *aff'd*, 883 F.2d 303 (3d Cir. 1987), *In re Cantrup*, 53 B.R. 104 (Bankr. D. Col. 1985); 2) whether a sale was under a confirmed plan, *see In re Permar Provisions, Inc*, 79 B.R. 530 (Bankr. E.D.N.Y. 1987); 3) whether the § 1146(c) exemption applies to plans of liquidation as well as reorganization, *see City of New York v. Smoss Enterprises Corp.* (*In re Smoss Enterprises Corp.*), 54 B.R. 950 (E.D.N.Y. 1985); or 4) whether the § 1146(c) exemption applies to a convertible mortgage, *see City of New York v. Baldwin League of Independent Schools* (*In re Baldwin League of Independent Schools*), 110 B.R. 125 (S.D.N.Y. 1990). No case even analyzed the issue presented here, much less reached a different result.

Petitioner also asserts that the interpretation of the § 1146(c) exemption by the court of appeals in this matter conflicts with, even "reverses" (5) that court's prior decision in *City of New York v. Jacoby-Bender, Inc.* (*In re Jacoby-Bender, Inc.*), 758 F.2d 840 (2d Cir. 1985). Even assuming that a split within a circuit were a basis for a grant of certiorari, *but see Davis v. United States*, 417 U.S. 333, 340 (1974), there is no split in the Second Circuit. The issue before the court of appeals in *Jacoby-Bender* was not the application of the exemption to the gains tax, but the applicability of section 1146(c) to a transfer that was arguably not a transfer under a chapter 11 plan. Although the court referred to the expansion of the stamp tax exemption to include state taxes, similar taxes and to apply to a broader class of debtors, 758 F.2d at 841-42, it clearly did not interpret the most recent statutory expression of the exemption, § 1146(c), as altering the nature of the tax relief in the original statute. Thus, the Court's decision in this case is consistent with *Jacoby-Bender*, not a reversal of it.[4]

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4 Petitioner is also incorrect in viewing the court of appeals' decision as a narrowing of the § 1146(c) exemption. (5). As the court of appeals stated, Section 1146(c) does not accord greater tax relief to debtors than

Petitioner's attempt to raise the question presented to one of national importance is unavailing. (12, 13). It is indisputable that only New York has a tax such as the gains tax. The possibility that other jurisdictions might enact an identical tax is pure speculation. Similarly, the prospect of further challenges by state and local governments to the section 1146(c) exemption does not make the issue worthy of review by this Court.

Although, large sums of money are at stake in this case, and the decision of the court of appeals may have an economic impact beyond the borders of New York, most, if not all of the Chapter 11 cases in which the applicability of the § 1146(c) exemption to the Gains Tax will arise, will be venued in bankruptcy courts sitting within the boundaries of the Second Circuit and bound to follow the court of appeals' decision. Because the Gains Tax is imposed only on transfers of real property within New York, even bankruptcy courts sitting outside New York (which occasionally dispose of property within New York) would be bound by *lex loci situ* to follow the court

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was formerly available. (13a, n.2). The court carefully traced the legislative history of both section 1146(c) and its predecessor, section 77B of the Bankruptcy Act of 1898 ("the Bankruptcy Act"), as amended [11 U.S.C. § 267 (repealed)], to show that the original exemption was first expanded to include state as well as federal stamp taxes and later to include taxes similar to stamp taxes. (*Id.*) Additionally, in the context of the goals of the Bankruptcy Reform Act of 1978, Public Law 95-598, 92 Stat. 2549 ("the Bankruptcy Code"), including removal of outdated restrictions on eligibility for bankruptcy relief, the language of section 1146(c) also reflects an extension of the exemption to a new class of debtors. *In re Jacoby-Bender*, *supra*. The former section 267 exemption had been available only to debtors who filed under former chapter X of the Bankruptcy Act. The new "consolidated" Chapter 11 of the Bankruptcy Code combined the bankruptcy relief available under former chapters X and XI, and Section 109 of the Bankruptcy Code, 11 U.S.C. § 109, removed the differing restrictions on eligibility for relief under each former chapter. Thus Section 1146(c) now extends the stamp tax exemption to debtors who would previously have qualified only for relief under former Chapter XI, and so would not have been entitled to the former section 267 exemption. Neither a wider nomenclature of exempted taxes nor a broader class of debtors eligible to claim the exemption is equivalent to changing the nature of the tax relief originally enacted.

of appeals' decision. Thus, although the petition raises a federal question, it is one of local, not national importance.

Petitioner also asserts that in rendering its decision, the court of appeals "simply ignored basic rules of statutory construction in interpreting the language of § 1146(c)." (6). In essence, however, petitioner disagrees only as to the relative importance of both the common and distinguishing characteristics between the court's definition of a stamp tax and the gains tax. The petition does not challenge the court's definition of the characteristics of a stamp tax.

For example, petitioner argues that it was misleading for the court of appeals to focus *only* on the tax rate. (9). This argument is belied by the decision below. The tax rate was only one of five factors considered by the court in determining whether the gains tax was a "stamp or similar tax."

Petitioner also argues that the court's determination that another characteristic of a "stamp or similar tax" is that the tax is determined solely by multiplying the tax rate by "either the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction" overlooks examples of stamp or similar taxes which are not calculated in that way. (17a) (10). Petitioner cites as an example, the New York Real Estate Transfer Tax ("RETT"), New York Tax Law § 1402, (McKinney 1987, Supp. 1992), which the court of appeals described as a stamp or similar tax. (16a). Petitioner points out that the RETT provides that the value of a continuing lien is excluded from the consideration, and thus concludes that the multiplicand, *i.e.*, the number by which the tax rate is multiplied, is "neither the consideration, the value of the property being transferred, nor par value." (10). This conclusion is flatly contradicted by the RETT statute (Tax Law § 1402) which defines the consideration to be taxed. The stamp tax statutes of other States cited by petitioner (10, 11) similarly define the consideration to be taxed. Thus, there is no possibility of the nation-wide confusion imagined by petitioner. (11).

Petitioner challenges as "unsubstantiated" the court of appeals' holding that the gains tax is imposed on gains, while stamp or similar taxes arise "solely from the act of transferring property or securities", because, it argues, the gains tax is imposed "even when a seller suffers a loss." (*Id.*)

In fact, the court of appeals explicitly recognized that the gain that is taxed is not the same gain that an accountant or an economist would recognize: "The fact that 'gains', *as calculated under the gains tax*, does not take into account certain development costs in no way alters this core attribute of the gains tax (19a)" * * * "It is the gain, *albeit as defined by the provisions of the gains tax*, that provides the key figure for determination of the amount owed under the tax." (20a). (Emphasis added.)[5]

Petitioner suggests that the "facts of this case" show that the gains tax is imposed on transfers in which there is economic loss incurred. (12). It bases this statement on the fact that creditors' claims are larger than the amount available for distribution. However, there is no causal connection between the amount of money realized on the transfer of petitioner's real property (determined by market forces), part of which was a taxable gain, and the size of the claims of its creditors. Thus, the purported loss in this case was not a loss on the lone taxed transfer, but an overall loss resulting from all of petitioner's operations.[6] The court of appeals thus correctly ruled that the

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5 Thus, petitioner's citation to the joint report of the New York State Bar Association Tax Section of the City of New York Committee on State and Local Taxation (11-12) should be disregarded. In the first place, it is not part of the record of this case. More importantly, it is irrelevant, because it does not substantiate petitioner's statement that the gains tax is imposed "when the seller suffers a loss." (11). Nowhere in the report, or, for that matter, in the statute or the regulations promulgated to enforce it is there any mention of the gains tax being imposed when there is no gain, as gain is statutorily defined.

6 Also, the implication that the claims of the Resolution Trust Corporation and the Federal Deposit Insurance Corporation are entitled to more favorable treatment than taxes (12) is contrary to the priority established by Congress in the Bankruptcy Code. In any bankruptcy case the amount available for distribution to creditors is always subject to the

gains tax is not a "stamp or similar tax" within the meaning of § 1146(c).

Petitioner attempts to couch its claim as one of constitutional dimension, by alleging that the doctrine of intergovernmental tax immunity forbids properties in bankruptcy from receiving less favorable tax treatment than properties subject to foreclosure sale. (13-17). This question, however, is not properly presented.[7] Petitioner did not raise this claim in any of the courts below, either in its Amended Complaint, its motion for summary judgment, or on appeal, and therefore, the court of appeals did not address the claim. Absent extraordinary circumstances not present here, an issue may not be raised for the first time in a petition for certiorari. *Delta Airlines v. August*, 450 U.S. 346, 362 (1981); Stern, Gressman & Shapiro, *Supreme Court Practice* at 364 (6th ed. 1986).[8]

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statutory first priority accorded to administrative expenses such as taxes. 11 U.S.C. §§ 503, 507. Moreover, section 1146(c), which, if applied to the gains tax, might result in such more favorable treatment for these and other creditors, contains no provision for the exercise of the Bankruptcy Court's equitable powers so as to apply the exemption or not, depending on the facts of a particular case.

7 Although this issue was presented below by Sanwa Bank, (15) which moved in the court of appeals for leave to file a brief, *amicus curiae*, in support of petitioner's petition for rehearing, the court of appeals denied *sub silentio* Sanwa's motion to file its brief. The court also denied the petition for rehearing. (98-99a).

8 In any event, petitioner lacks standing to make the argument, since, as it concedes, neither petitioner, nor any other Chapter 11 debtor would have to pay the gains tax under Sanwa Bank's allegedly discriminatory scenario. (15-16).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Dated: New York, New York
September 28, 1992

Respectfully submitted,

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AUG 25 1992

No. 92-363

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

995 FIFTH AVENUE ASSOCIATES, L.P.,

Petitioner,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* OF L.A. COTTON & CO., INC. AND ITS SOLE SUCCESSOR-IN-INTEREST, LINDA A. GUTERMAN, IN SUPPORT OF PETITIONER

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NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* OF L.A. COTTON & CO., INC. AND ITS SOLE SUCCESSOR-IN-INTEREST, LINDA A. GUTERMAN, IN SUPPORT OF PETITIONER

1. L.A. Cotton & Co., Inc. and its sole successor-in-interest, Linda A. Guterman (hereafter "LAC") respectfully move the Court for leave to file the within brief *amicus curiae* in support of petitioner. Both petitioner and respondent have declined to grant consent to the filing of this brief.

2. In support of its motion, LAC avers:

3. LAC is a party in interest of petitioner's bankruptcy estate, against which it holds a claim in the approximate amount of $4.8 million. The outcome of this case directly affects LAC, because the point in issue—whether respondent, the State of New York, can retain approximately $2.6 million

that it removed from petitioner's estate in order to pay a "priority" state tax—will affect LAC's ability to have its own claim paid.

4. While LAC recognizes that assumption of *amicus curiae* status at the petition stage is not favored by the Court, it notes that its interest in this case goes beyond that of an ordinary *amicus curiae*. LAC is a party in interest and, as such, it has a statutory right to be heard on any issue arising in petitioner's bankruptcy case, especially an issue such as that presented, which directly affects the matter of payment to LAC. *See*, 11 U.S.C. §1109(b) and *Matter of Marin Motor Oil, Inc.*, 689 F.2d 445 (3rd Cir. 1982), *cert. denied*, 459 U.S. 1206 (1983). Without prejudice to its right to appear as "intervenor", rather than simply *amicus curiae* (*see*, *Marin*, *supra*), LAC respectfully requests that its arguments as *amicus curiae* be heard and considered by the Court.

5. LAC respectfully submits that those arguments will aid the Court in deciding whether to grant *certiorari*, and how thereafter to dispose of the case, because the annexed brief amicus curiae raises crucial constitutional, historical and policy arguments that were overlooked by petitioner. LAC hopes that its brief *amicus curiae* will be of assistance to the Court, and it respectfully moves for leave to file it.

Dated: New York, New York
September 22, 1992

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QUESTION PRESENTED

What are the parameters for determining whether a tax is a "stamp tax or similar tax" under 11 U.S.C. § 1146(c)?

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BRIEF *AMICUS CURIAE* OF L.A. COTTON & CO., INC. AND ITS SOLE SUCCESSOR-IN-INTEREST, LINDA A. GUTERMAN, IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

This brief is respectfully submitted on behalf of L.A. Cotton & Co., Inc. and its sole successor-in-interest, Linda A. Guterman ("LAC"). LAC is a creditor of the estate of the debtor-petitioner herein ("995"), against which it holds a claim in the approximate amount of $4.8 million. Payment of the New York tax which is the subject of this case will substantially reduce LAC's ability to receive payment on its claim under 995's confirmed plan of reorganization.

SUMMARY OF THE ARGUMENT

Section 1146(c) of the Bankruptcy Code exempts a Chapter 11 estate from payment of a "stamp tax or similar tax" that is imposed on "the making or delivery of an instrument of transfer under a plan confirmed" under Chapter 11 of the Code. The State of New York imposes a tax on the transfer of real property within its borders. That tax has two components, one of which applies to all such transfers and another which applies only to transfers where the consideration exceeds $1,000,000.

As part of its Chapter 11 reorganization, and pursuant to a Bankruptcy Court order that was designed to effectuate that reorganization, 995 sold real property situated within New York for a sum exceeding $1,000,000. While New York does not dispute that that transfer was exempt from the first component of its transfer tax, it contends that it is not exempt from the second component, which applies to million dollar plus transactions. Neither the first nor the second component of New York's transfer tax requires the use of any tax stamps.

Both the Bankruptcy Court and the District Court held that, as a matter of law,[1] the second component of New York's transfer tax was a "stamp tax or similar tax" under 11 U.S.C. §1146(c), so that 995 would be exempt from that component as well. The Court of Appeals for the Second Circuit reversed that summary judgment, holding that, because the *computational*

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1 It is questionable whether any court, be it the Bankruptcy Court, the District Court or the Court of Appeals, could properly make a "matter of law" determination on the issue of "similarity". This Court has previously held that "similarity", even when that term is simply part of a statute, is a question of fact. *See, Greenleaf v. Goodrich*, 101 U.S. 278 (1879). Irrespective of whether "similarity" is resolved as a question of fact or as a question of law, it is important for the Bankruptcy Court to know what parameters it should be operating under in making a determination of "similarity". As discussed below, the parameters enunciated by the Court of Appeals are not the correct ones. Indeed, were they to be followed, those parameters would undermine federal supremacy and uniformity—free from state interference—in the area of Chapter 11 reorganizations.

attributes of "stamp" taxes differ from the computational attributes of the million dollar plus component of New York's transfer tax, the lower courts' determination of "similarity" was erroneous.

The Court of Appeals' narrow approach to "similarity" is flawed in several respects. First, that court's perception of how stamp taxes are computed is at odds with the most notorious stamp tax in this country's history, the Stamp Act that Great Britain imposed on the thirteen colonies. The Court of Appeals' narrow approach to what constitutes a "similar" tax is also at odds with history, particularly the response that the founders of this country had to the "similar" Townshend Act "duties" that Great Britain employed to replace its objectionable "stamps". Indeed, if the founders of this country had had the same narrow perspective on "similar" taxation that was indulged by the Court of Appeals, our great revolution for independence—prompted in no small measure by Great Britain's imposition of "stamp" and "similar" taxes on the thirteen colonies—might never have occurred.

However, the most serious flaw in the Court of Appeals' reasoning is that that court failed to consider what evil Congress was trying to prevent, and what federal policy it was seeking to promote, by enacting 11 U.S.C. § 1146(c). That policy—to enable federal courts to reorganize bankrupts free from state-specific transaction-oriented taxes which impede reorganization and prevent federal "uniformity" in the area—is undermined by the narrow approach that the Court of Appeals took to the "similar tax" issue. That policy, which is one of constitutional dimension, because it deals with the fundamental allocation of state/federal power in the area of bankruptcy reorganizations, was overlooked by the Court of Appeals.

It is respectfully submitted that this case warrants the attention of this Court and that, upon review, so much of the order and decision of the Court of Appeals as established unduly narrow parameters for resolving the "similar tax" issue should be reversed.

ARGUMENT

THE COURT OF APPEALS' NARROW APPROACH TO "SIMILARITY" JEOPARDIZES CONSTITUTIONAL UNIFORMITY AND FEDERAL SUPREMACY IN THE AREA OF BANKRUPTCY REORGANIZATIONS

Why Did Congress Choose "Stamp" Taxes?

11 U.S.C. § 1146(c) provides:

> "The issuance, transfer or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax."

Neither the Bankruptcy Code nor its legislative history define the terms "stamp tax" or "similar tax" used in this statute. Given that vacuum, the Court of Appeals made its analysis of the attributes of a "stamp tax" by focusing solely on the *computational* aspects of such a tax. Having taken that narrow approach, the Court of Appeals proceeded to find "dissimilarities" between "stamp taxes" and the New York transfer tax in issue.

The error in the approach that the Court of Appeals adopted to the "similarity" issue lay in the fact that nowhere did that court consider what it was about stamp taxes *in particular* that prompted Congress to preclude their being imposed on a transfer that a federal court has deemed necessary to effectuate a Chapter 11 reorganization. Only by first answering *that* question—never addressed by the Court of Appeals—can one proceed to the issue of what Congress intended when it expanded 11 U.S.C. § 1146(c) to include not only "stamp" taxes, but "similar" taxes as well.

As the Court of Appeals noted in a predecessor case involving 11 U.S.C. § 1146(c), there is no doubt that

> "Congress's apparent purpose in enacting section 1146 was to facilitate reorganizations through giving tax relief."

In re Jacoby-Bender, Inc., 758 F.2d 840, 841 (2d Cir. 1985). If, however, Congress' intent was simply to grant across-the-board tax relief to reorganizing debtors, why limit such relief to stamp taxes, as opposed to property taxes or income taxes? The broad statement in *Jacoby-Bender, supra*, simply does not answer the fundamental question: what is it about *stamp taxes* that makes them particularly invidious *in the bankruptcy context*?[2]

Section 1146(c) Is A "Check And Balance" On The Absolute Priority That Section 503(b) Accords State Taxes

The starting point for answering the above question must be the Constitution's recognition, in Article I, Section 8, Clause 4, that the rehabilitation of bankrupts is a matter for federal control. Under the constitutional scheme, such federal control is not limited to companies which have interstate contacts. Congress' power over the affairs of such companies was already implicit in the Commerce Clause of Article I. The Bankruptcy Clause of Article I went beyond that, making it clear that the federal government's power over the rehabilitation of bankrupts is to be supreme in *all* cases and that, where state law threatens to impede the effectuation of a federally-sponsored plan of reorganization, the state must yield.

Having been endowed with such supremacy, Congress could, in the interest of debtor rehabilitation, have placed a state's tax claims against a bankrupt on an equal footing with those of his private creditors. Such "equal footing" would facilitate reorganizations, because, if a state could not "take first", there would be more to share among the bankrupt's private creditors, thereby increasing the likelihood that the debtor could formulate a reorganization plan that would meet with those creditors' approval. Congress, however, decided to be more generous with the states than it had

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2 What constitutes a "stamp tax" in the non-bankruptcy context (*e.g.*, *Lee v. Bickell*, 292 U.S. 415 (1934) may be illuminating, but it is hardly dispositive of the issue at bar, because Section 1146(c) also applies to "similar tax". Only when one determines what peculiar threat stamp taxes pose to *bankruptcy reorganizations* can one then determine what types of non-stamp taxes are likewise proscribed by Congress' "similar tax" language.

to, and it accorded them a great boon: absolute "priority" for state tax claims under 11 U.S.C. § 503(b)(1)(B).

The priority that subdivision (B) of 11 U.S.C. § 503(b)(1) accords state taxes is *absolute*. Unlike subdivision (A) of Section 503(b)(1), a state tax does not have to meet the "preserving the estate" test in order to qualify for priority treatment as an administrative expense.

As this Court noted in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819), "the power to tax involves the power to destroy". If Congress left the absolute priority accorded by subdivision (B) of 11 U.S.C. § 503(b)(1) totally unchecked, there would be nothing to prevent a state from imposing a tax that could gobble up a bankrupt's estate in a manner that would hamper its ability to effect a reorganization. Control over bankruptcies, which the Constitution removed from the states to the federal government, could, through the device of unchecked "priority" taxation, effectively revert to the states, who, by simply imposing a tax, could hold the power of life and death over a bankrupt's reorganization.

It is apparent that Section 1146(c) was designed as a "check and balance" upon the absolute priority of state taxes. Section 1146(c) checks the states' ability to tax particular *transactions*. Because, when a state taxes *the very transaction that a federal court has deemed necessary to effectuate a plan of reorganization*, such tax impedes federal supremacy in the reorganization area. Such a tax cannot be given priority. Indeed, under Section 1146(c), such a tax cannot be imposed at all.

The invidiousness of "stamp taxes" lies in the fact that, traditionally, such taxes have been used to tax the ability to *engage in particular transactions*. Unlike income taxes, which tax the conduct or income of a taxpayer *as a whole*, and unlike property taxes, which tax property irrespective of what *transactional* use has been made of it, a stamp tax imposes its burden *on particular transactions*.

When, as in the case of a stamp tax, a transaction is, *by itself and irrespective of other conduct by the taxpayer*, made subject to

state taxation, the state has the power to prevent, discourage or impede such transaction.[3] When the *transaction* adversely affected by such *state* taxation is one that a *federal* bankruptcy court deems necessary to a federally-sponsored plan of reorganization, constitutional supremacy demands that the state yield. Yielding on such a point is easily accomplished, because that which Congress has given it can freely take away. In Section 503(b)(1)(B), Congress gave the states general priority in bankruptcy when it comes to their taxes. In Section 1146(c), Congress tempered that priority with a specific exclusion for *transaction*-oriented taxes, such as "stamp" taxes or "similar" transaction-oriented taxes.

The Court Of Appeals' Narrow Approach To "Similarity" Misfocused On Computations Rather Than On Constitutional And Federal Policy Considerations

Once one recognizes the underlying constitutional federal-state tension which made it inevitable that state taxation of *transactions* necessary to effectuate a federally-sponsored reorganization would have to be exempted from the priority accorded by Section 503(b)(1)(B), it is easy to comprehend why Congress expanded Section 1146(c) to include not only "stamp" taxes, but "similar" taxes as well. Without such broad language, "stamp tax" could be read literally, rather than in its constitutional *policy* context, thereby jeopardizing that constitutional policy. Without the "similar tax" language, all a state would have to do in order to avoid the policy against impeding transactions necessary to a federally-approved reorganization with a transaction-oriented tax would be to impose such a tax without requiring "stamps".

Unfortunately, in adopting the narrow approach to "similarity" that it did in this case, the Court of Appeals replaced the evil that would flow from a *literal* interpretation of "stamp tax" with an equally destructive *stilted* interpretation of the "simi-

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3 New York uses the transfer tax in issue in such a "coercive" manner. Thus, New York does not allow a deed for transferred real property to be recorded unless that transaction-oriented tax is first paid. *See*, N.Y. Tax Law § 1447(1)(f).

lar tax" language. In assessing whether the transaction-oriented tax imposed by New York State was a "similar tax", the Court of Appeals narrowly focused only on those attributes of "stamp taxes" *which bear no relationship to the policy behind Section 1146(c)*. The Court of Appeals did not focus on *why* Congress had decided to treat "stamp" taxes differently, nor *why* it was necessary to expand such special treatment to "similar" taxes. The Court of Appeals simply assumed that Congress had *arbitrarily* decided to give a bankrupt relief from stamp taxes, without looking to see what evil Congress was trying to prevent by doing so. As noted above, that "evil" is the fact that a stamp tax—being a transaction-oriented tax—upsets the ability to reorganize a financially distressed company, because it taxes (and therefore impedes or, at the very least, makes less desirable) the very transaction that a federal court has deemed necessary to effectuate such a reorganization.

That the Court of Appeals misfocused on attributes of a "stamp tax" that have nothing do with the policy behind Section 1146(c) is clear from its preoccupation with the "dissimilarity" between the "high" rate of New York's transaction-oriented tax and the "low" rate that, according to that court, stamp taxes supposedly have. This "dissimilarity" has nothing to do with the policy behind Section 1146(c). Indeed, if anything, a high transaction-oriented state tax is *more* destructive of the ability to implement a federal reorganization than a low one.

The Court Of Appeals' "Computational" Approach Is Irreconcilable With History

Moreover, the Court of Appeals' view that stamp taxes are not "high" taxes was arbitrary and irreconcilable with history. Thus, in analyzing what it deemed to be the attributes of a stamp tax, the Court of Appeals skipped over that stamp tax which is the most notorious one in our history, namely, the Stamp Act that Great Britain imposed on the thirteen colonies. That stamp tax is analyzed, in detail, in Knollenberg, *Growth of the American Revolution 1766-1775* (Free Press, 1975). As noted in that treatise, the

stamp tax that the Stamp Act imposed on advertisements in Benjamin Franklin's *Pennsylvania Gazette* amounted to around 80% of that publication's advertising revenue and 70% of its subscription revenue. *Id.* at 49 and at 305, nn. 12 and 13. With respect to the *Boston Chronicle*, the same stamp tax amounted to about 86% of that publication's price. *Id.* at 305, n. 14. With respect to the *Astronomical Diary*, the impact was even worse—the stamp tax amounted to twice the cost of that publication. *Id.* at 305, n. 15. It is to state the obvious that such stamp taxes were not "low".

The Stamp Act also demonstrates the mistake in the Court of Appeals' view that stamp taxes must be based on the "consideration for" or "value" of a particular transaction. The *varying* impacts of stamp taxes on the aforesaid colonial publications were due to the fact that the Stamp Act was not directed at the amount of consideration paid, or value involved, but, rather, on particular "transactions" *irrespective of their monetary amount*. Thus, among the several transactions that it taxed, the Stamp Act taxed the transaction of "using paper". Accordingly, even if the *Pennsylvania Gazette* and the *Boston Chronicle* paid different amounts to purchase the paper that they used, they nevertheless paid the same stamp tax for each sheet that they used, because "consideration" and "value" were irrelevant. And if, as in the case of the *Astronomical Diary*, paper was used to print an "almanac", the stamp tax on such "using paper" was different, even if *Astronomical Diary* paid the same "consideration" for its paper as did the *Pennsylvania Gazette* and the *Boston Chronicle*.

The Court of Appeals' preoccupation with "how is the amount of tax computed?", as opposed to "is a particular transaction being taxed?", renders its opinion fundamentally flawed. There is no way to prescribe a "uniform rule", such as "low percentage of total consideration paid", for determining what is or is not a stamp or similar tax. Because, as noted above, it is perfectly possible for the computation of a stamp tax to have *nothing* to do with "consideration paid". The common thread which runs through all stamp taxes is not how they are computed, but what they tax. If the tax is directed at a particular

type of transaction, as opposed to the activities of a taxpayer *as a whole*, then it is a tax "similar" to a stamp tax.

On the issue of what kind of tax is "similar" to a stamp tax, the Court of Appeals overlooked yet another key event in American history. After the colonists objected to the Stamp Act, England replaced it with the Townshend Act. The Townshend Act involved no "stamps". Nor was it *directly* assessed against transactions engaged in by the colonists. Instead, under the Townshend Act, England levied a duty on the importation of various items into the colonies, many of which corresponded to ones whose use had previously been subjected to the purchase of stamps under the Stamp Act.

The Farmer's Letters, a series of colonial essays which has been described as having

> "an influence beyond that of any other political writing in the Revolutionary period except Paine's *Common Sense*,"

(*Growth of the American Revolution, supra*, at 49), attacked the Townshend Act on the ground that "names will not change the nature of things" (*Id.* at 51), and that, since the ultimate economic effect of the Townshend Act's "duties" was the same as the Stamp Act's "stamps" (*i.e.*, to tax the colonists for engaging in certain transactions), it was equally objectionable.

The observation that "names will not change the nature of things" is as meaningful in analyzing the concept of "similar" tax today as it was in assessing the similarity between the Townshend Act and the Stamp Act more than two centuries ago. If New York required persons to buy tax "stamps" in order to engage in the transaction of transferring a parcel of real property, there is no doubt that such a transaction-oriented tax would fall within 11 U.S.C. § 1146(c). It would not matter how the amount of "stamps" to be purchased would be calculated (*e.g.*, on the total consideration paid, on a fraction of the consideration paid, on the amount of square feet in the property, etc.), because the fact would remain that what was being taxed was that a particular type of transaction had been engaged in. Now, what if the state abolished the need to buy "stamps", but

simply assessed a tax for engaging in the same type of transaction. Would that not be a "similar" tax?

Why then is the tax in issue not a "similar" tax? The target of that tax—engaging in a particular type of transaction—is no different than the target of a stamp tax. The economic effect of that tax—making it prohibitive to engage in a particular type of transaction—is no different from that of a stamp tax. Where then is the "dissimilarity"? In how the amount of tax is computed? But, as noted above, no "uniform rule" can be found in that regard when it comes to stamp taxes.

The Court of Appeals' "Computational" Approach Is Otherwise Flawed

Because the matter of how the amount of tax is computed is irrelevant to the issue of whether a particular tax is "similar" to a stamp tax, the Court of Appeals' attempt to paint the tax in issue as being "dissimilar", because its amount is computed by looking only to a *portion* of the consideration paid, is flawed. The Court of Appeals held that, since, in its view, stamp taxes are always based on a percentage of *total* consideration paid, the fact that New York calculates its tax on only *part* of that consideration renders that transaction-oriented tax "dissimilar". Initially, we note that this purported "dissimilarity" is at odds with the other one that the Court of Appeals misfocused on. On the one hand, the Court of Appeals insisted that a "similar" tax must be "low". On the other hand, that court insists that such a tax must be computed as a percentage of the whole, rather than only a part—a mode of calculation that is bound to yield a higher, rather than a lower, rate.

That the "part" of consideration that New York looks to in order to compute the amount due under its transaction-oriented tax is called "gain" by that state does not change this flaw in the Court of Appeals' reasoning. As the District Court in this case noted, the word "gain" as used in New York's transaction-oriented tax law is a misnomer. New York's arbitrary definition of "gain" does not reflect true economic gain or loss. 127 B.R. at 541. Indeed, depending on the amount of "soft costs" that an owner of real property incurs in effecting its sale (costs that are

disregarded under New York's arbitrary definition of "gain"), the tax in issue can end up being imposed on the transaction of transferring property even though such transaction results in economic loss. *See*, Note, *Real Property Taxation*, 35 Syracuse L. Rev. 609, 613-15 (1984).

"Names will not change the nature of things." Despite its misleading reference to "gain", the tax in issue does not tax *income*. It taxes a *transaction*. When true gain is generated by a sale of real property, New York taxes it under its state income tax law (N.Y. Tax Law, Art. 22), a law that does not tax individual transactions, but, rather, taxes the taxpayer *as a whole*. The tax in issue taxes a particular transaction—the transfer of real property—as an isolated event.

The manner in which New York requires the tax in issue to be reported leaves no doubt that it is a transaction-oriented tax. Thus, New York's taxation of the transaction of transferring real property has two components: a "base" tax on such transfer and a "surcharge" tax on such transaction. The "base" tax applies to all transfers of real property and is calculated as a percentage of the total amount of consideration paid. *See*, N.Y. Tax Law § 1402. The "surcharge" applies only to those transactions where the total consideration exceeds $1,000,000. In such cases, the amount of the surcharge is calculated as a percentage of only part of the consideration for the transfer, *i.e.*, that part which meets the state's arbitrary definition of "gain".[4] As noted above, New York's arbitrary definition of "gain" bears no relationship to true economic gain. Rather, it is simply a "formula"—no different than if the state said that it was only surcharging the first five million dollars of the total consideration, or only the second five million dollar increment of such consideration, etc.

That the amount of transaction-oriented tax that is calculated by using this computational "gain formula" is nothing more

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4 This "part of consideration" formula for million dollar plus transactions applies only to non-residential real property. *See*, N.Y. Tax Law § 1443(2). When it comes to residential property, a "total consideration" formula is used for imposing a surcharge on million dollar plus transactions. *See*, N.Y. Tax Law § 1402-a.

than a "surcharge" on a "base" tax is obvious from section 1409(d) of New York's Tax Law. That section requires the "gain formula" component of the transfer tax to be reported *on the same return form* as the "base" component of that tax. The "surcharge" nature of the "gain formula" tax could not be clearer.

Given the Court of Appeals' determination, in a prior case, that the transfer tax imposed by the *City* of New York (which is indistinguishable from the aforesaid "base" component of the *State* of New York's transfer tax) is within the "similar tax" exemption of 11 U.S.C. § 1146(c) (*see, Jacoby-Bender, supra*), that court's subsequent refusal to accord similar treatment to the "surcharge" component of that tax—simply because it is computed differently from the "base" tax—is untenable.

The reorganization of a company in bankruptcy oftentimes requires a transfer of property. Once a federal bankruptcy court determines that such a transfer should be made, a state is not free to impede the effectuation of that federal scheme by taxing *the very transaction that the federal court has decreed.* Irrespective of whether such a transaction-oriented tax involves the use of stamps, its imposition is barred by Section 1146(c). Irrespective of whether such a transaction-oriented tax is a "base" tax or a "surcharge" tax, its imposition is barred by Section 1146(c). Just as it is irrelevant to a transaction-oriented tax which involves the use of stamps how the amount of tax is computed, so, too, it is irrelevant to *any* transaction-oriented tax how its amount is computed. If the tax targets a transaction, as opposed to the taxpayer as a whole, it is a "similar" tax within the meaning of 1146(c).

The Tax In Issue Jeopardizes Federal Supremacy And Uniformity In The Area Of Bankruptcy Reorganizations

That the tax in issue, by virtue of its transaction-oriented nature, places an undue burden on federally-supervised reorganizations is apparent from a decision by New York's highest court which was rendered *after* the Court of Appeals' decision herein. In *Matter of Morgan Guaranty Trust Company of New*

York v. Tax Appeals Tribunal of the New York State Department of Taxation and Finance, ____ N.Y.2d ____, 1992 N.Y. Lexis 1595 (June 9, 1992), New York's highest court was confronted with the issue of whether the "gain" tax in issue, although one of "general application", nevertheless places such an undue burden on ERISA plans as to be preempted by ERISA. It held that it did. New York's highest court held that the impact that the "gain" tax in issue has on a property owner's investment strategies (*e.g.*, what to buy and sell) and on the depletion of such owner's assets (by taking a direct bite out of the proceeds of their transfer) is such that it unduly interferes with the federal scheme of "uniformity" mandated by ERISA.

The policy considerations are no different when one considers the "uniformity" in federal control that is mandated by the Bankruptcy Clause of the Constitution. Like the administrator of an ERISA Plan, a federal bankruptcy court is charged with the duty of supervising and approving transfers of property that are necessary to a bankrupt's reorganization. Moreover, just as the assets of an ERISA Plan are held in trust for its beneficiaries, so, too, the assets of a bankrupt's estate are held in trust for its *pre-existing* creditors. When a state purports to create a *new* "priority" claim upon those assets—by taxing the very transaction that a federal court has ordered to reorganize the bankrupt, so that its previous creditors can be paid—the state depletes that trust fund. Moreover, by injecting a state-specific, transaction-oriented tax into the "reorganization equation", the state requires the federal court to make its "investment strategies" regarding reorganization (*e.g.*, what property of the bankrupt should be sold) in a non-uniform manner. A federal judge dealing with property of a bankrupt in a state that has a transaction-oriented tax will have to handle his or her reorganization of the bankrupt in a manner different from that of a federal judge dealing with identical property of a bankrupt in a jurisdiction that does not have such a transaction-oriented tax.

New York's highest court has held that the burdens and non-uniformity that the "gain" tax in issue places on the federal ERISA scheme warrant preemption of that state tax. We respectfully sub-

mit that the apparent policy behind Section 1146(c) warrants a like result in this case. The tax in issue is "similar" to a stamp tax *in those ways that matter*. Its purpose is "similar"—to tax isolated transactions, rather than the taxpayer as a whole. And its deleterious effect on the federal scheme is "similar"—it impairs federal "uniformity", directly depletes the assets of a federally-supervised estate, and makes federal formulation of an effective plan of reorganization that much harder.

The Court of Appeals' decision in this case is an invitation to states and municipalities to abuse the priority that 11 U.S.C. § 503(b)(1)(B) accords them, and wreak havoc upon bankruptcy reorganizations, by simply enacting a transaction-oriented tax that (i) does not entail the use of "stamps", (ii) imposes a "high" rate of taxation, and (iii) employs artificial "gains" formulas (or other "part of consideration" formulas), and then use such "priority" tax to gobble up the proceeds of a transfer that a federal court has decided is necessary for a bankrupt's reorganization. This loophole to the important policy underlying Section 1146(c) should be closed by this Court.

The closing of this loophole is of national importance even if the other circuits decline to follow the narrow test of "similarity" that the Second Circuit employed in this case. Even if that test were to be confined to the Second Circuit, the burden on the constitutional scheme would be too great. The Constitution removed control over the rehabilitation of bankrupts from the states to the federal government. To let even one federal court allow even one state to reverse that process, and exercise state taxing power over a federally-decreed transfer-in-aid-of-reorganization, is a situation that is constitutionally intolerable. Cf. *McCulloch v. Maryland, supra.*

CONCLUSION

It is respectfully submitted that this Court should grant certiorari review in this case and that, upon such review, so much of the order and decision of the Court of Appeals as took a narrow approach to the "similar tax" issue should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

995 FIFTH AVENUE ASSOCIATES, L.P.,

Petitioner,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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The Second Circuit reversed the decisions of the bankruptcy court and the district court, and found that the tax imposed by N.Y. Tax Law §§ 1440 *et seq.* (the "Gains Tax") was not a "stamp tax or similar tax," and thus did not fall within the exemption provided by § 1146(c) of the Bankruptcy Code. It arrived at this conclusion by revising the test applied by the district court for defining a "stamp tax or similar tax." The inability of the respondents to provide even a plausible defense of this revised test reflects the indefensible nature of the court of appeals decision and the need for this Court's review.

ARGUMENT

Respondents admit that "large sums of money are at stake in this case, and the decision of the court of appeals may have an economic impact beyond the borders of New York. . . ." Brief in Opposition at 5. For example, Bloomingdale's flagship store in Manhattan is a prized asset in a bankruptcy case in Ohio, *In re Federated Department Stores, Inc.*, S.D. Ohio, No.1-90-00130. Nevertheless, respondents deny the issues raised in the Petition will have more than local significance, because bankruptcy courts outside of New York would be bound to follow the Second Circuit's decision. Brief in Opposition at 5-6. Obviously, if an unjustifiable opinion by the Second Circuit will control the decisions of bankruptcy courts across the nation, this factor provides only more, not less reason for this Court to grant the Petition.

Respondents also claim that this case is only of local importance because "[i]t is indisputable that only New York has a tax such as the gains tax." Brief in Opposition at 5. An explanation provided in New York's official publication for administering the Gains Tax demonstrates the fallacy in this reasoning:

> 75. Deductibility of the Gains Tax
>
> Q. Is the gains tax deductible from both federal and state income tax?
>
> A. In light of Federal Revenue Ruling 80-121 which held that *a similar Vermont land gains tax* constituted a "transfer tax" and is deductible for purposes of computing adjusted gross income under section 164(a) of the Internal Revenue Code, it is the Department's position that Article 31-B of the Tax Law also constitutes a transfer tax, and is therefore deductible. However, the Internal Revenue Service will ultimately determine its deductibility for federal tax purposes which will then apply for state tax purposes.

N.Y.S. Dept. of Taxation and Finance, *Questions and Answers—Gains Tax on Real Property Transfers*, p.27, Publication 588 (November 1984) (emphasis added).

This statement and analysis in New York's official publication on the Gains Tax, which is based upon the "similar" natures of the Gains Tax and the Vermont land gains tax, contradicts the claim in the Brief in Opposition that the characteristics of the Gains Tax are so singular so as to make it *sui generis*. Moreover, it is the approach and unjustifiable test that the Second Circuit has created for defining a "stamp tax or similar tax" which creates the legal question which warrants this Court's attention, not simply the application of the § 1146(c) exemption to the Gains Tax.

In attempting to deny the national significance of the opinion below, respondents have distorted its reasoning and language. Respondents assert that the opinion below states: "Section 1146(c) does not accord greater tax relief to debtors than was formerly available. (13a, n.2)." Brief in Opposition at 4-5, n.4. However, footnote 2 in the decision below reads:

> The report of the House Judiciary Committee stated that "[s]ection 1146(c) of title 11 broadens the exemption to any stamp or similar tax." H.R. Rep. No. 595, Cong., 1st Sess. 281(1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6238. We disagree with the district court to the extent it concluded that this statement reflects Congress's intent that the words "stamp or similar tax" be read broadly to accord greater tax relief for debtors. Instead, we regard this statement as a simple declaration that the new provision, *§ 1146(c), enlarges the former exemption under § 267 to include taxes similar to stamp taxes.*

(13a,n.2) (emphasis added).[1] No logical reading of this footnote could result in the conclusion that the Second Circuit stated: "Section 1146(c) does not accord greater tax relief to debtors than was formerly available."

Respondents are desperately seeking to avoid giving footnote 2 a natural reading, because in the decision the Second Circuit simply failed to analyze the meaning of the term "similar tax."

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1 The pages of the appendix to the Petition are referred to as "___a".

Although respondents claim that the Second Circuit "interpreted the words used by Congress, 'stamp tax or similar tax' in accordance with 'their ordinary, contemporary, common meaning,' " Brief in Opposition at 2-3, such a claim is another distortion of the opinion. Respondents do not question that such an approach is mandated by this Court's earlier opinions. However, in its decision it is only the term "stamp tax" that the Second Circuit attempts to give an " 'ordinary, contemporary, common meaning.' " (14a-15a). As is more fully described in the Petition, unlike its approach to understanding the meaning of the term "stamp tax," the Second Circuit simply ignored interpreting the term "similar tax" once it concluded that no definition was available from a review of the legislative history. In an attempt to conceal this critical failure in the decision the respondents misquote the decision in the Brief in Opposition.

This failure by the Second Circuit is of critical importance because it was by adding the term "similar tax" that Congress broadened the earlier Bankruptcy Act's stamp tax exemption. *City of New York v. Baldwin League of Independent Schools (In re Baldwin League of Independent Schools)*, 110 Bankr. 125, 126-27 (S.D.N.Y. 1990). This recognition of an expansion of the exemption was central to the Second Circuit's earlier decision interpreting § 1146(c), *City of New York v. Jacoby-Bender, Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840 (2d Cir. 1985). Courts across the nation have utilized *Jacoby-Bender* as a basis for defeating attempts by governmental entities to impose a narrow interpretation on the § 1146(c) exemption. *In re Cantrup*, 53 Bankr. 104 (Bankr. D. Col. 1985); *CCA Partnership v. Director of Revenue (In re CCA Partnership)*, 70 Bankr. 696 (Bankr. D. Del.), *aff'd*, 72 Bankr. 765 (D. Del.), *aff'd*. 883 F.2d 303 (3d Cir. 1987); *City of New York v. Smoss Enterprises Corp. (In re Smoss Enterprises Corp.)*, 54 Bankr. 950 (E.D.N.Y. 1985); *In re Permar Provisions, Inc.*, 79 Bankr. 530 (Bankr. E.D.N.Y. 1987); *City of New York v. Baldwin League of Independent Schools (In re Baldwin League of Independent Schools)*, 110 Bankr. 125 (S.D.N.Y. 1990). Rather than demonstrating that the decision below is only of local significance, by

stating that the Second Circuit now reads § 1146(c) as not "accord[ing] greater tax relief to debtors than was formerly available," the respondents have demonstrated how the decision below will be used to impose an unreasonably narrow interpretation on the § 1146(c) exemption in contrast to the position repeatedly taken by other courts, including the Second Circuit itself in *Jacoby-Bender*. The decision thus invites unwarranted court challenges and the manipulation of state tax laws in an effort to circumvent the § 1146(c) exemption.

Respondents claim that the Petition did "not challenge the court's definition of the characteristics of a stamp tax," but only disagreed with "the relative importance of both the common and distinguishing characteristics between the court's definition of a stamp tax and the gains tax." Brief in Opposition at 6. This statement reflects the inaccurate and disingenuous character of the Brief in Opposition. The Petition focused upon three characteristics identified by the Second Circuit—the alleged imposition of the Gains Tax only upon transactions which yield a profit, the base upon which the tax is imposed, and the Gains Tax's ten percent rate—because it was these three characteristics which the Second Circuit found as taking the Gains Tax outside of the § 1146(c) exemption. *See* 15a-20a and Brief in Opposition at 3. The "relative importance" of these characteristics is crucial because if these alleged differences are non-existent or inconsequential, allowing them to determine whether the Gains Tax falls within the § 1146(c) exemption essentially eliminates the "similar tax" exemption from the Bankruptcy Code. The basic fault in the decision below is that it simply identified what it believed were three differences without weighing their significance, notwithstanding the language in § 1146(c) which states that taxes which are "similar" to stamp taxes fall within the exemption.

As the Second Circuit failed to analyze the significance of the alleged differences it identified, the respondents are forced to rely upon sophistry to support the decision. The Brief in Opposition states:

> For example, petitioner argues that it was misleading for the court of appeals to focus *only* on the tax rate. (9). This argument is belied by the decision below. The tax rate was only one of five factors considered by the court in determining whether the gains tax was a "stamp tax or similar tax."

Brief in Opposition at 6. Of course, Fifth Avenue Associates never argued that the Second Circuit's decision was based only upon a finding that the Gains Tax was imposed at a high rate—in excess of one percent, the rate claimed by the Second Circuit to be "typical" of a stamp tax. Instead, in response to one of three characteristics relied upon by the court of appeals to distinguish the Gains Tax from a stamp tax, Fifth Avenue Associates maintained that simply addressing the relatively higher rate of the tax was misleading. When one takes into account the narrower base upon which the Gains Tax is imposed, the higher rate does not result in a tax with an order of magnitude which can be distinguished from a "stamp tax or similar tax." *See* Petition at 9. Respondents are unable to justify the significance the Second Circuit attributed to the Gains Tax's higher rate, so they simply attempt to defend the opinion in the Brief in Opposition by misstating the arguments of Fifth Avenue Associates.

Equally distorted is respondents' defense of the Second Circuit's position that the Gains Tax is not a "stamp tax or similar tax" because it is imposed on neither " 'the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction.' " Brief in Opposition at 6. Although Fifth Avenue Associates cited many exempt taxes which fail to satisfy any of these criteria because the value of assumed liens is excluded in calculating the amount of consideration, respondents state:

> This conclusion is flatly contradicted by the RETT statute (Tax Law § 1402) which defines the consideration to be taxed. The stamp tax statutes of other States cited by the petitioner (10, 11) similarly define the consideration to be

> taxed. Thus, there is no possibility of the nation-wide confusion imagined by petitioner. (11).

Id. Obviously, the confusion which may be engendered by the Second Circuit's decision will not stem from the failure of the relevant state statute to define the consideration. Confusion will arise because the definition of the consideration to be taxed will not conform to the Second Circuit's requirements for defining a tax which falls within the § 1146(c) exemption.

Fifth Avenue Associates' concern for the possibility of "nation-wide confusion" is not "imagined." When the Second Circuit issued its initial opinion in this case, major New York law firms warned their clients that the court's definition of a "stamp tax or similar tax" threatened the continued application of the § 1146(c) exemption to the New York City Real Property Transfer Tax. It was only after the Second Circuit amended its opinion to modify its initial requirement that a "stamp tax or similar tax" must have a rate of one percent or less, that this fear was allayed. However, the continuing dangers arising from the amended opinion are reflected in the inability of the respondents to defend the propositions upon which the decision is based.

The foremost proposition upon which the decision relied was the premise that the Gains Tax was "always contingent on the profitability of the underlying transaction." (19a). As Fifth Avenue Associates described in the Petition, in a recent joint study by The Association of the Bar of the City of New York and the New York State Bar Association, the Gains Tax was found to be imposed even when losses are incurred in a transfer. Petition at 12. The respondents claim this finding is irrelevant because "[n]owhere in the report . . . is there any mention of the gains tax being imposed when there is no gain, *as gain is statutorily defined.*" Brief in Opposition at 7, n.5 (emphasis added). Obviously, the relevant question is not whether gain exists as gain is defined by the statute. The issue is whether the statute defines real gain or whether the Gains Tax is imposed even when losses are incurred in a transaction. The respondents are unable to provide support for the central

proposition upon which the decision rests, so they rely repeatedly upon arguments which misstate the issue.

Finally, respondents claim that Fifth Avenue Associates improperly has requested that this Court decide whether the Gains Tax violates the doctrine of intergovernmental tax immunity. Brief in Opposition at 8. Again, the respondents have misrepresented the arguments in the Petition rather than responding to the issue raised. Fifth Avenue Associates has not asked this Court to decide whether the Gains Tax violates the Constitution. Instead, it has urged this Court to grant the Petition because by addressing the Second Circuit's faulty construction of § 1146(c) the Court may avoid the later necessity of deciding the delicate constitutional question arising from the Gains Tax's discriminatory treatment of secured lenders in bankruptcy.

The distortions and sophistry upon which respondents rely reflect the lack of substance in the Second Circuit's decision. Even respondents recognize the economic significance of the issue involved. The Second Circuit has inexplicably reversed its earlier approach to § 1146(c), and instead has imposed a narrow, ill-considered test which cannot withstand scrutiny. As the Second Circuit's decision in *Jacoby-Bender* influenced courts across the nation, so will its mischaracterization of the § 1146(c) exemption create major problems in reorganizations unless the decision is subject to this Court's review. In a period when public and private entities are mired in massive real estate collapses, this Court should not allow the Second Circuit's indefensible opinion to undermine reorganizations.

CONCLUSION

For the foregoing reasons, respondents' arguments in opposition to the petition for a writ of certiorari should be rejected and the writ should issue.

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